Direct Line Group

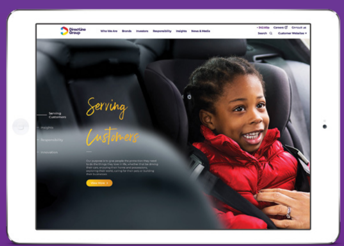
Annual Report & Accounts 2018

Contents

ESG – our approach

Information on our environmental, social and governance ("**ESG**") related activities is structured according to the five pillars of our approach to responsibility. These pillars, activities in the year relating to responsibility, and where to find ESG related information are set out in the Responsibility section. This also contains information on how we satisfy the requirements of the Non-Financial Reporting Directive.

Read more on pages 50 – 51



For more information please visit
www.directlinegroup.co.uk/en/investors/esg.html

Our performance reflects our focus on satisfying customers with the aim of delivering sustainable, profitable growth

Profit before tax

£582.6m
(2017: £539.0m)

Return on tangible equity[1]

21.5%
(2017: 23.0%)[2]

Combined operating ratio[1,3]

91.7%
(2017: 90.8%)[2]

Solvency capital ratio[1,4]

170%
(2017: 165%)

Operating profit[1]

£601.7m
(2017: £642.8m)[2]

Dividend per share[5]

29.3p
(2017: 35.4p)

Notes:
1. See glossary on pages 191 to 192 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off profits within the Motor segment. The adjusted profit after tax reported in 2017 was £462.9 million and the return on tangible equity was 21.7%.
3. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration. See glossary on page 191 for definitions.
4. Estimates based on the Group's solvency II partial internal model. The 2017 comparative has been updated to reflect the amounts in the Group Solvency and Financial Condition Report for the year ended 31 December 2017.
5. See page 32 for the dividend policy.

One Group

We give people the protection they need to do the things they love in life.

Whether that be driving their car, enjoying their home and possessions, exploring the world, caring for their pets or building their businesses.

Our strength lies in the diversity of our propositions, offering a range of products, powerful brands and multiple routes to market, underpinned by a determination always to aim higher for our customers, people, shareholders and wider stakeholders.

Eight brands

Direct Line stands for speed, simplicity and a common-sense human touch. We sell products direct to customers by phone and online.

Direct Line customers want a premium product with exceptional customer care that is tailored to their needs at a competitive price.

Churchill is one of Britain's most recognisable brands, providing car, home, business, pet and travel insurance. Our products are available by phone and online, including price comparison websites.

Churchill customers are looking for a dependable partner which is reliable, trustworthy, and will spend time making sure they are happy.

Direct Line for Business understands that our customers' businesses are their livelihoods, so the right type of cover is vital. Our policies cover a range of trades, from start-ups, to growing businesses, from renting out a property to working as a single tradesman. We sell products direct via phone and online.

Green Flag is our roadside rescue and recovery service. It is a standalone and optional product offered alongside motor insurance across all of our brands.

Green Flag customers receive an award-winning breakdown service at a much cheaper price than its two biggest rivals.

Privilege targets customers who mainly buy through price comparison websites.

Privilege customers want a quick and efficient service at the best price.

NIG is our commercial insurance brand dedicated to the broker market and is focused on a number of specialisms including small and medium-sized enterprises, agriculture and real estate.

DLG Partnerships is the Group's partnerships arm. It specialises in providing personal insurance, and roadside rescue and recovery products to some well-known brands.

DLG Auto Services is the Group's UK network of bodyshops, repairing around 90,000 accident damaged vehicles every year, and supports our seven day repair proposition for Direct Line customers.

Find more details on our website

Four segments

Motor

We are Britain's leading personal motor insurer measured by in-force policies[1], mainly represented through our well-known brands Direct Line, Churchill and Privilege, and also through our partners.

Gross written premium

£1,671.2m

Operating profit

£415.2m

Home

We are one of Britain's leading personal home insurers measured by in-force policies[1]. We reach our customers by selling home insurance products through our brands Direct Line, Churchill and Privilege, and our partners RBS, NatWest and Prudential.

Gross written premium

£606.9m

Operating profit

£83.1m

Rescue and other personal lines

We are one of the leading providers of rescue and other personal lines insurance in the UK[2,3], with 7.5 million in-force policies. This includes providing roadside assistance and recovery for customers through Green Flag, the UK's third largest roadside recovery provider[2]. We offer customers protection for their holidays and pets and are the third largest travel and the third largest pet insurer[3]. We also offer insurance packages tailored for mid-to high-net worth customers.

Gross written premium

£422.8m

Operating profit

£43.4m

Commercial

We protect commercial businesses through our brands, NIG, Direct Line for Business and Churchill. NIG sells its products exclusively through brokers operating across the UK.

Gross written premium

£511.0m

Operating profit

£60.0m

Find more details on pages 38 – 43

Notes:
1. Includes Direct Line, Churchill, Privilege and partner brands: RBS, NatWest, Prudential and Sainsbury's © GfK Financial Research Survey six months ending January 2018, 14,063 adults interviewed for motor insurance and 12,214 for home insurance.
2. Mintel Vehicle Recovery – UK, September 2018.
3. Mintel Pet Insurance – UK, August 2018 and Mintel Travel Insurance – UK, February 2019.

Three routes to market

Every customer is unique and we want our products to reach customers wherever they shop. But we don't stop there. We also want to give them choices about their insurance and we offer our products through the three main routes to market:

Direct

We give our customers a reason to come direct with our strong brands and great propositions, because we want to deliver excellent value for our customers and shareholders.

Price comparison websites

Strong brands and propositions are important but so are great prices. We are investing in the latest generation IT to improve our speed to market and pricing capabilities.

Partnerships

We partner with big brands to offer insurance to their customers and look for ways to be innovative to give people choice about how they insure the things they love.

1 million

Own brand policies added since 2014

710,000

Policies sold through price comparison websites[1]

173,000

Motor partnerships customers drove their new car away with our complimentary insurance[2]

Find more details on page 19

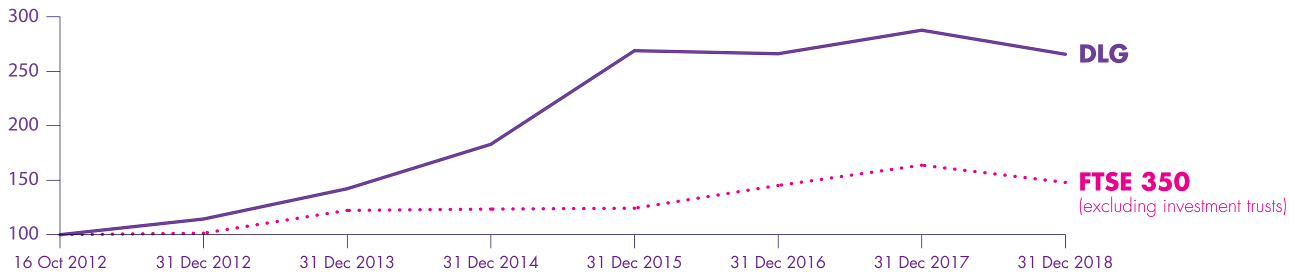
Note:
1. Number of new policies sold through Churchill and Privilege for Motor and Home in 2018.
2. www.directlinegroup.co.uk/en/brands/dlg-partnerships.html

Six years of returns

Creating shareholder value through customer focus

We have a track record of delivering strong returns to shareholders having distributed £2.5 billion in dividends over the past six years. This together with our share price performance has delivered an attractive total shareholder return.

Total shareholder return (%)



Our successful customer focused strategy, built around our 'rocket' (see page 19), also enables us to invest in future capabilities with the aim of sustaining our strong performance.

Medium-term financial targets

Combined operating ratio 93% – 95%	**Return on tangible equity of at least 15%**	**Grow our regular dividend in line with business growth**	**Maintain solvency capital around the middle of the 140% – 180% solvency II target range**

2018 results

91.7%	**21.5%**	**21.0p**	**170%**

Find more details on pages 24 – 25

Delivering sustainable returns

In 2018, the Group delivered profit before tax of £582.6 million (2017: £539.0 million). The Group's diversified product and channel portfolio, disciplined underwriting and our engaged employees have helped us to achieve this commendable result.

Governance highlights

Leadership
Your Board seeks to ensure that decisions are of the highest standard. It challenges strategic proposals, performance delivery and management responsibilities.
See page 66

Effectiveness
The effectiveness of your Board's and its Committees' performance is considered annually in an effectiveness review.
See page 70

Accountability
Your Board provides shareholders with an assessment of the Group's position and prospects. We monitor and review the effectiveness of the Group's risk management and internal control systems.
See page 74

Remuneration
Your Remuneration Committee ensures a close correlation between creating value for shareholders, and remunerating Executive Directors and senior executives appropriately.
See pages 75 and 88

Relations with shareholders and stakeholders
Your Board maintains strong relationships and regular interaction with shareholders. Their continued support for the strategic aims is important. Your Board also has regard to the interests of other stakeholders.
See pages 66 and 75

CEO succession

Following a rigorous search process, the Group was delighted to announce, on 26 February 2019, that Penny James, Chief Financial Officer ("**CFO**") had been selected to succeed Paul Geddes as Chief Executive Officer ("**CEO**") with effect from the conclusion of the Annual General Meeting ("**AGM**") on 9 May 2019. Paul will step down as a member of the Board and will leave the Group at the end of July 2019.

Penny joined the Board on 1 November 2017 and succeeded John Reizenstein as CFO on 1 March 2018. Penny's deep understanding of our sector, combined with outstanding leadership skills, financial and risk expertise and deep strategic thinking, gives the Board confidence that Penny is ideally suited to leading the delivery of the Group's short-term strategic imperatives, including technological and business transformation, and the development of the next stage of our strategy.

This year marks the 10th anniversary of Paul's appointment as CEO. In that time Paul has made a huge contribution to the Group and the Company is deeply indebted to him for his strong leadership. During his tenure, Paul has been leading the management team which successfully separated the business from the Royal Bank of Scotland Group, floated it on the London Stock Exchange and turned it into a successful FTSE 100 company. The Board thanks Paul for his enormous contribution and wishes him well for the future.

Strategy

The Group aims to make insurance much easier and better value for our customers. The Board supports and challenges the Group's management to develop and execute a strategy which is aligned to this aim. Our strategy looks to position us as a multi-brand, multi-product and multi-channel business, to enable us to meet our customers' needs now and in the future, regardless of their channel preference.

Supporting this strategy is a substantial and ongoing change and investment agenda. We look to continue to invest in our direct offering, as we believe it enables us to deliver the best value for our customers and our shareholders, through our differentiated brands and propositions and simple customer journeys. Our investments in technology and digitisation are intended to improve competitiveness, agility and efficiency. This also supports our ambition to grow our profitable share of the price comparison websites market, particularly by moving us towards best-in-class pricing. By leveraging our manufacturing strengths and investments in digital capabilities, we are continuing to support our aim of winning new partnerships.

Dividends and capital management

The Group's solvency capital ratio prior to all proposed dividends was 194%, resulting from good capital generation from the business and lower capital requirements due in part to increasing the level of reinsurance purchased by the Group in recent years. This was partially offset by higher unrealised mark to market losses due to credit spread widening and continued capital expenditure as the Group invests with the aim of improving its capabilities and efficiency.

The Group aims to grow the dividend in line with business growth. Accordingly, the Board has recommended a final dividend of 14.0 pence per share (2017: 13.6 pence), an increase of 0.4 pence per share. If approved, the total regular dividend of 21.0 pence per share will represent 2.9% growth on 2017's regular dividend (20.4 pence per share). This reflects the Board's continued confidence in the Group's earnings and the progress the business continued to make.

The Board also resolved to pay a special interim dividend of 8.3 pence per share. After both dividends, the solvency capital ratio will be 170% as at 31 December 2018[1].

The Board has taken into account the high level of political and economic uncertainty, including in relation to the UK's exit from the EU ("**Brexit**") and considers it appropriate for the time being to maintain a prudent solvency capital ratio towards the upper end of the solvency capital ratio risk appetite range of 140% to 180%. The Board will keep this position under review as it monitors developments in the political and economic environment. In normal circumstances, the Board expects the Group to operate around the middle of its solvency capital ratio risk appetite range.

Brexit

Brexit, when the UK is due to leave the EU, is scheduled to take place on 29 March 2019. Although the Group is predominantly a UK business, it does, for example, have exposure to financial markets and it imports goods and services in order to fulfil insurance claims, including from the EU. The Group has been monitoring events carefully and proactively taken steps to mitigate the likely impact on the Group to the extent we consider it to be appropriate and proportionate to do so, given the considerable uncertainties; however, in the event of a disruptive Brexit the Group will not be immune. We have more information on this in the Risk section, on page 48.

ESG practices

The Board subscribes to the principle that a business model that is sustainable in the long term will be better able to drive value for its shareholders and other stakeholders, contributing to the development of a sustainable economy. The Group has strong values and is customer focused to ensure it is continuing to meet customer needs. The Board is proud of the high level engagement of its people, whose wellbeing is one of the pillars in our approach to ESG, reflected in our support for Mind and the Scottish Association for Mental Health as well as numerous wellbeing initiatives across the Group. Our investment portfolio has started to be weighted towards 'green bonds' and investments which attract higher ESG ratings. Each of our UK offices seeks to act constructively with the local community and we encourage our people to allocate at least a day each year out of their working lives to support charitable or community initiatives. Our people donated nearly 4,800 hours of company time to volunteer within their communities during 2018.

Note:
1. Further information can be found on page 32.

Linking remuneration to performance

We remain committed to ensuring that executive pay is aligned with the Company's strategy of targeting sustainable shareholder and customer value. This is primarily achieved by the Annual Incentive Plan ("**AIP**") and Long Term Incentive Plan ("**LTIP**") being aligned to performance measures shareholders consider important. This is underpinned by the delivery of a significant proportion of remuneration through shares and shareholding requirements.

The Group achieved a return on tangible equity ("**RoTE**") of 21.5% for 2018. A decrease of 16.5% (2017: an increase of 3.3%) in the share price over the year to 318.7 pence (2017: 381.7 pence) at 31 December 2018, together with dividend payments, provided a total shareholder return ("**TSR**") of minus 7.7% for the year (2017: 8.1%). This compares favourably to the FTSE 350 which had an overall return of minus 9.5% at 31 December 2018 as financial markets reacted to global trade tensions and Brexit. Over the past five years, shareholders have received a TSR of 87% compared to the FTSE 350 (excluding investment trusts) of 22%. The Group has continued to deliver good results each year, which has enabled the Board to declare cumulative dividends, including special dividends, equivalent to approximately 106% of the Initial Public Offering ("**IPO**") share price. More information on the Group's remuneration policy and share awards are disclosed in the Directors' remuneration report on pages 88 – 117.

IT infrastructure

The Board continues to provide oversight of the ambitious programme of activity to upgrade and better integrate the major IT systems within the Group's technology infrastructure, aimed at improving the Group's digital offering, customer experience and operational efficiency. Good progress has been made in this area and 2019 is set to be an important year for the Group in terms of the delivery of the new platform.

Customer, culture and conduct

Meeting the needs of our customers is central to the Group's strategy and sustainability. The Board recognises that opportunities will arise to improve further the services offered to customers, and along with its investment in IT capability to improve the efficiency and effectiveness of the business, it has also encouraged a range of customer experience initiatives which are designed to deliver increased levels of customer satisfaction.

The Group maintains active relationships with its insurance regulators through constructive dialogue. The Board promotes an open and collaborative culture, and provides oversight of the Group's conduct with customers. It oversees the Group's culture and the conduct policy, which aims to ensure that fair customer outcomes are achieved and that employees behave with integrity. The Group also has an Employee Code of Conduct which sets out standards to which our employees are required to adhere.

Board and Committee membership changes

Further to the announcement of the new CEO you will recall from my statement last year that John Reizenstein and Andrew Palmer stepped down from the Board at the conclusion of the AGM in May 2018.

Three Non-Executive Directors ("**NEDs**") joined the Board in 2018: Mark Gregory and Gregor Stewart were appointed on 1 March; and Fiona McBain joined us on 1 September. The Board is already benefiting from their skills and experiences.

Clare Thompson, independent NED, has decided to step down from the Board at the conclusion of the 2019 AGM. Having served as a Director since 2012, Clare has made an immense contribution to the Group. Her experience and wisdom have been invaluable in helping the Board and senior management to deliver excellent results for shareholders and customers. She leaves the Board with our thanks and best wishes for the future.

The Chairs of three Board Committees also changed during 2018. Gregor and Mark were appointed as Chair of the Audit Committee and Investment Committee respectively replacing Andrew Palmer. Danuta Gray also replaced Clare Thompson as Chair of the Remuneration Committee.

I would like to thank each member of the Board for their significant contribution, commitment and service, and look forward to working with them in 2019 as the Group continues to strive to build on its success to date.

Employees

The Group's employees are fundamental to the Group's success and sustainability and to ensuring a high level of service to our customers. I would like to thank each of them for their hard work, initiative and commitment to our mission. Their positive energy, embodiment of the Group's values and unwavering dedication to our customers have helped our businesses progress over the successful years since the IPO, and have put us in a strong position for the future.

MICHAEL N BIGGS
CHAIRMAN

Focusing on our customer-centric mission

> I am pleased to announce a strong set of results driven by our resilient business model which performed well in a highly competitive market.

I am pleased to report another strong set of results in a highly competitive market driven by the Group's resilient and customer-centric business model. We continued to make significant operational progress in 2018 and we head into a pivotal year of delivery in 2019, with the aim of delivering a springboard from which to grow the contribution from current-year profitability. We maintained good cost discipline in 2018 and are determined to leverage our investment in the business to step change our efficiency. The new technology and greater efficiency are, in turn, designed to support our ambition to innovate more rapidly and find new ways to serve our customers as their demands evolve. Financially, we continued to see the benefits of improving the efficiency of our balance sheet, which has contributed to another attractive dividend, while continuing to invest in the business and maintaining a prudent solvency margin.

Trusted brands and direct growth

Once again, the growth we achieved across Direct Line, Direct Line for Business and Green Flag demonstrated that by giving customers a reason to come to us direct, they will. Since 2014, our own brand in-force policies have grown by over one million, to over seven million policies.

In Direct Line we launched another two new unique propositions – in Home and Motor. Our new Motor proposition removed one of our customers' greatest frustrations and protected their no claim discount on no-fault claims. We now offer a combination of nine Direct Line propositions that our customers cannot get anywhere else in the market.

Direct Line for Business achieved its 11th consecutive year of premium growth. This time last year, we launched a more personalised approach for our business customers, from start-ups to growing businesses. Starting with Hair and Beauty and followed by Bed & Breakfast in 2017, this year we ramped up our delivery by releasing cover for over 500 new trades, taking us to 75% of our target trades on the new platform. A national marketing campaign was launched in the year and the early campaign metrics have been positive. This has driven higher volumes to the website and there has been a 100% increase in brand searches. Work is underway to re-launch two of our biggest products on our new system, Van and Tradesman in 2019. This continues to demonstrate our increased ability to work in an agile way and to launch new, innovative products quickly to meet the ever-changing needs of our customers.

And finally Green Flag, our challenger brand in the Rescue market, continued to display great growth potential and demonstrated this again by achieving another period of double digit percentage growth in policy count and premiums. Our Rescue network dealt with over 640,000 breakdowns in 2018, which is one every 49 seconds. There has been great progress in Rescue in 2018, launching a five-year transformational plan and the team have relocated to a Centre of Excellence, bringing together multi-skilled teams to recognise efficiencies and offer greater flexibility. The Rescue Me app, which is rated 4.8 in the Apple App store, was rebuilt using in-house digital capabilities and was used in over 35,000 claims.

Moving towards best in class in the price comparison website market

We see a real opportunity in strengthening our capabilities on price comparison websites. We increased our focus in 2018 and created a new trading hub in Motor and Home to support this. We made some tactical pricing changes driven by improved anti-fraud capabilities and this helped increase Churchill and Privilege Motor new business volumes by 18%. We believe there is an opportunity to strengthen margins in this channel.

Investing in technology

Whilst we have already made significant progress in delivering our Direct Line for Business systems, most of our transformational work has been going on behind the scenes on our core personal lines technology, as we continued our ambitious programme to build our latest generation IT capabilities.

These systems, which started to go into testing at the end of 2018, are designed to make insurance much easier for our customers by introducing more self-service and customer focused innovations. In addition they are designed also to enable a step change in our ability to use internal and external data more effectively to improve our pricing accuracy and improve our competitiveness. Our new pricing engine is designed to make it much easier and quicker to develop, test and deploy new models. This is intended to allow us to tailor our models better to the price comparison website channel and improve our speed to market. We are also in the process of testing our new digital Travel platform. 2019 is an important year in starting to deliver these systems which we see as a key enabler in transforming our business.

We continue to make good progress on our alternative pricing project which we expect to give us new capability by applying new data science methods and machine learning. We believe this approach will enable us to deepen our competitive footprint with more granular and flexible pricing capabilities. Testing is progressing well and we are aiming to launch in Q2 2019 under a new brand.

Improving our efficiency

In order to be able to give our customers the best value for money, we recognise it is imperative to operate efficiently. Over the past five years, we've made significant strides in reducing our costs, such as through improved marketing efficiency, where we reduced marketing spend by over 30% whilst returning our direct own brands to growth, and reducing our number of sites by nearly a half and annual rental costs by around 40%.

Over the past two years we have been expanding our robotic process automation capability and are now managing concurrently 28 processes and approximately 500,000 automated transactions each quarter. But we don't intend to stop there and have already identified a strong pipeline of processes to add to our existing portfolio and which has the potential to increase our transaction volume capability by a further 500,000 in 2019.

The actions we've taken supported the reduction in the operating expense ratio and we aim to continue to transform our business and improve our efficiency and long-term competitiveness.

Leveraging our scale via partnerships

In Home, we leveraged our capabilities in digital and data to streamline the customer experience. Our improved capabilities in digital are helping us have conversations with potential new partners.

In Travel, we are building a new system that is designed to enable customers to self-serve and interact with us day or night, offering greater support and helping us renew our partnerships with RBS Group and Nationwide.

In Motor, our new partnership with Volkswagen Insurance Service (Great Britain) Limited is going well. We provide both annual insurance cover and complimentary '5 day driveaway' cover for customers buying new and used cars from Volkswagen, Volkswagen Commercial Vehicles, SEAT, Audi and ŠKODA dealers.

Investing in our talented people

The success of the business is due to the commitment and dedication of our people who use their expertise to serve our customers. We rightly celebrate our diversity and are united in our customer focus. This focus is reflected in our unique propositions and the fact that on average we manage one claim every single minute of every single hour, every day of the year. The freezing weather earlier in the year hit many drivers, households and businesses hard, and the way our people helped our customers get their lives back on track during this difficult period demonstrated the value of our insurance cover and gives customers a reason to keep coming back to us. Nearly 10,000 of our people now own shares in our company which gives them a real sense of ownership and investment in our future success. Our engagement scores increased again in 2018 and I'm proud that this year we came third in the Sunday Times list of the 25 Best Big Companies to Work For in 2019[1]. This is a huge achievement and is testament to the value we place in our people.

Business performance

We ended 2018 having delivered a sixth successive year of strong financial performance and a return on tangible equity of 21.5% (2017: 23.0%), well ahead of our target of at least a 15% return on tangible equity.

Our direct own brands gross written premium increased by 1.8% whereas total gross written premium was lower as expected due to the exits from Nationwide and Sainsbury's Home partnerships. We achieved an operating profit of £601.7 million (2017: £642.8 million). The reduction in operating profit was primarily due to lower prior-year reserve releases and investment return. Both years benefited from reserve releases relating to the Ogden discount rate. In respect of 2018, we have now assumed a higher Ogden discount rate of 0%, following Royal Assent of the Civil Liability Act 2018 which contributed £55 million to operating profit (2017: £49 million) of which £51 million related to the prior years.

Weather returned to normal levels in 2018 after a benign 2017 and this offset the non-repeat in 2018 of the £57 million non-cash impairment charge incurred in 2017 in relation to IT projects. Normalised for weather and adjusted for the assumed Ogden discount rate change, the combined operating ratio was approximately 93.5%, towards the lower end of our medium-term target range of 93% to 95%.

Overall, our current-year combined operating ratio was stable, demonstrating the value in the Group's diversified product base and channel portfolio, as well as lower operating expenses.

Regulation

The Group has continued to operate within a highly dynamic and evolving regulatory landscape, where there are a number of reviews and initiatives, including those that have been announced by the UK Government, the FCA and the PRA.

In 2018 both the FCA and PRA have been focused on Brexit preparations and the implementation of the Senior Managers and Certification Regime. The PRA's focus continues to be on the pillars of its financial risk framework, namely reserving, pricing, reinsurance and investments. The FCA has also been focused on pricing practices including the launch of its market study. The Group is supportive of the FCA's market study. At this early stage however, the outcomes are not yet known.

The insurance market is very competitive with high levels of switching and lots of introductory discounts which leads to most people shopping around for the best deal. For those customers who don't shop around it is crucial that insurers have active pricing processes for all their long-term customers. We have had these measures in place for several years and increasing numbers of long-standing customers have seen their renewal premium either frozen or reduced as a result. We worked closely with the Association of British Insurers on their pricing principles and actions on premiums which we hope will embed best practice across the whole industry.

Outlook

The Group targets a combined operating ratio of 93% to 95% for 2019 and over the medium term, normalised for weather. Over time, the Group expects to increase the contribution from current-year underwriting as the contribution from prior-year reserve releases reduces. The latter is predominantly as a result of increasing the level of reinsurance purchased by the Group in recent years which has reduced the risk profile of the Group.

The targeted improvement in current-year underwriting profitability is supported by the significant investment the Group is making in building future capability. This aims to improve the current-year loss ratio by delivering additional pricing sophistication and supporting multiple initiatives to combat fraud. In addition, the Group is targeting to improve efficiency through self-service and digitalisation. These improvements are targeted to emerge over a number of years. In 2019, the Group expects to make further progress in reducing operating costs and is targeting operating expenses below £700 million. We reiterate our ongoing target of achieving at least a 15% return on tangible equity.

As I prepare to hand over the reins to Penny not only do I look back over the last ten years with great pride, I also look to the future with great excitement for our customers, people and shareholders. Over the next 12 months, as we begin the roll-out of our new core personal lines IT applications, we plan to increase our flexibility to deal with changing business requirements, offer more self-service and deliver more straight-through processing. This combined with our leading brands and great people will help Direct Line Group with its mission to make insurance much easier and better value for its customers.

PAUL GEDDES
CHIEF EXECUTIVE OFFICER

1. www.b.co.uk/the-lists/big-companies/

New customer expectations

The pace of technological change and new regulatory requirements demands an agile response, combined with smart investment choices, to deliver what our customers want.

	Development	Impact	Action
Technology	Digital technology	Digital innovation allows insurers to interact with consumers in new, more effective ways.	Our latest generation IT capabilities went into testing at the end of 2018. These are designed to allow us to provide more targeted products with improved customer journeys, by delivering greater pricing agility with increased data flows, more product flexibility and increased self-service, amongst other benefits.
Technology	Data	Insurers are gaining greater data insight as devices become ever-more connected.	We are driving performance through advanced analytics, for instance by creating better understanding of rescue claims in our Green Flag business.
Technology	Artificial Intelligence, Machine Learning and Robotics	New systems enable customers to access quicker self-service at lower cost and pricing to become fairer and more accurate.	We are exploring the use of new approaches across our value chain, including the use of machine learning techniques in pricing and the use of robotics across our business, which is currently delivering 500,000 transactions a quarter.
Technology	Security	Digitalisation and technology bring a risk to information security.	We have invested in a range of cloud-enabling security measures and have been working closely with a range of peer groups to tackle security risks affecting the entire industry.
Technology	In-Car Technology	Sophisticated technology is changing vehicles, including the advent of electric and autonomous cars.	We remain partners in leading in-car technology projects StreetWise and MOVE_UK, helping us to gain insight into the development of autonomous vehicles and the impact on liability and claims.
Market	Claims	Claims inflation has returned to long-term expected trends.	We have once again added to our accident and repair centre network, helping us to manage costs.
Market	Customers	Customers are increasingly looking for unique insurance products, tailored to their needs.	We have launched a combination of nine new Direct Line propositions unique in the insurance market. Direct Line for Business has extended its proposition to target over 500 small and micro trades.
Market	Partnerships	Partnerships enable us to leverage unique distribution and/or access data to streamline the customer experience and create competitive advantage in our pricing and underwriting.	We continued to grow the number of home insurance policies through our partnership with RBS Group, and renewed our Travel agreements with Nationwide and RBS Group for another five years. We also signed a five-year deal with Volkswagen Insurance Service (Great Britain) Limited, providing motor insurance using five Volkswagen Group brands.
Regulation	Civil Liability Act	The Act will introduce new measures to reform the soft-tissue whiplash injury compensation system and introduce a new framework for setting the Ogden discount rate.	We are working with the Government to help design the new online portal for whiplash claims that will come into force in 2020.
Regulation	Pricing	The Financial Conduct Authority has launched a General Insurance Pricing Practices Market Study.	We have signed up to the Association of British Insurers' guiding principles and action points to help with how renewal premiums are dealt with, building on our review of long-term and potentially vulnerable customers. Increasing numbers of long-standing customers have seen their renewal premium either frozen or reduced.

Find out more about our Strategy on pages 19 – 21

A strategy targeting sustainable growth

Our strategy looks to position us as a multi-brand, multi-product and multi-channel business to enable us to meet our customers' needs now and in the future, regardless of how and where they buy our products. Supporting this strategy is a substantial and ongoing change and investment agenda.

Our strategic pillars

Great retailer
We have compelling brands and multiple customer propositions and deliver a strong customer experience which we constantly evolve to meet the needs of our customers.

Smart and efficient manufacturer
Our scale and data allow us the efficiency and flexibility to deliver better customer and claims service and better risk insights.

Lead and disrupt
By embracing the future, we aim to shape it and launch new products and services which anticipate consumer trends so that we continue our tradition of disruptive change.

Our key enablers

Data and technology
We aim to harness the power of technology and the scale of our data to make things easier for our customers and our people.

Culture and capability
We invest in our people to help them realise their potential because it leads to better customer experience and more sustainable business performance.

Capital and risk management
We maintain an appropriate level of capital and solvency to manage our customers' pool of risks while understanding, monitoring and managing our own existing and emerging risks within carefully defined parameters.

Our multi-channel approach

Direct
The growth in Direct Line and Green Flag demonstrates that if you give customers a reason to come direct then they will, as we strive to deliver excellent value for our customers and our shareholders.

Price comparison websites
Strong brands and propositions are important but so are great prices. We are improving our effectiveness on price comparison websites through our work on pricing and in dealing with fraud, supported by our investment in latest generation IT systems.

Partnerships
We are leveraging our manufacturing strength through our digital capabilities to seek to develop innovative and profitable partnerships.

Read about our progress in 2018 on pages 20 – 21

Strategy in action

As a forward-looking and proactive business, we are constantly evolving our offer to meet our customers' needs and taking advantage of significant advances in technology. In 2018 we continued to improve our competitiveness, agility and efficiency across the business.

Connecting with our customers

Our people are committed to doing their very best for our customers and our business every day. We are particularly proud of how our people step up to the challenge to get our customers' lives back on track during severe weather periods such as the freezing weather we saw in Q1 2018. One of our values is to aim higher and we actively encourage everyone to push themselves and learn new strengths. We know that customers have differing needs when it comes to buying insurance, which is why we use our frontline experience to develop new propositions based on customer feedback.

It is also why we introduced a training programme called CONNECT, which has been accredited by the Institute of Customer Service, for our people in a customer facing role. This training helps to ensure that our customers receive a personalised service which matches their expectations and needs. The programme enables our people to learn about the different approaches customers may take and gives them the skills to respond with empathy, whilst also taking responsibility and accountability. This is important for our customers who are dealing with difficult situations such as illness or bereavement and vulnerable customers who need additional help to ensure that their cover is the right cover for them. Based on the CONNECT training, our people who successfully demonstrate high levels of customer service receive a certificate of accreditation from the Institute of Customer Service. The impact is clear from customer benchmarking studies which measure the willingness of customers to recommend products or services, adding to our ability to maintain strong customer retention rates.

Bristol

Our new Bristol office, The Core, has created a new and dynamic environment for our people to serve our customers. It has given our people a variety of new workspaces to support collaboration and flexible working, all in a fully refurbished building half the size of our previous site.

Environmental considerations were central to the design. LED lighting, new chillers, heating, ventilation and an air conditioning system have made the site more energy efficient. Run costs are now 55% lower than they were in 2016. The Core is the latest example of how we are looking to shape our technology and workspaces for the future, while meeting our environmental objectives. We are proud it has reduced our carbon emissions in our Bristol office by 62%.

Latest generation IT systems

We continue to build our latest generation IT capabilities designed to enable much more customer self-service and straight-through processing and to give our customers easier and quicker service at a lower cost whilst improving the efficiency and flexibility of the business.

Over the next few years we also plan to wind down and then remove our existing mainframe, while growing our use of the cloud. This is planned to give us flexibility in the future to deal with changing business requirements and changes in technology.

Green Flag

We believe our challenger brand has great growth potential and demonstrated this again by achieving another period of double digit growth in policy count and premiums. Our marketing targets the two-thirds of major competitors' customers who renew without much thought and aims to 'wake them up' by dramatising how we match the best things about their service whilst saving half their renewal premium.

We know that service matters a lot in this market – customers won't sacrifice it for price. We've brought in new leadership and brought the business together – not only in reporting lines but also physically to create rescue 'centres of excellence' to deliver this great service. We will be using many of the same agile techniques that have proved successful in delivering fast and affordable change for Direct Line for Business.

640,000

breakdowns responded to in 2018 – that's 1 every 49 seconds

Price comparison websites

This year a working group has focused on establishing a price comparison website hub aiming to drive capability across the Group by assessing customer needs throughout the entire price comparison website sales journey. A dedicated team, using digital resource and data analytics, is seeking to build greater expertise and agility in real time, enabling better insight on pricing and the opportunity for swifter decision-making. This is important for a sales platform that operates on very different market dynamics compared to selling direct. By working across product lines the working group has instilled a price comparison website-focused philosophy to safeguard against functional thinking that can otherwise restrict effectiveness.

Accident repair centres

We continued to expand our network of accident repair centres and now have 20 sites across the UK, giving us more capability to deliver our seven day repair proposition for Direct Line customers. This year alone, we repaired over 85,000 vehicles, building on our excellent record of customer service. By investing in the latest technology we are preparing the business for the future by better understanding how technology will affect the design and manufacture of cars.

Our high operating efficiency has also allowed us to deliver excellent cost control while meeting our environmental targets through lowering emissions and increased recycling of parts.

85,000+

vehicles repaired

Renewal pricing principles

The lack of barriers to shopping around for insurance brings substantial benefits to consumers who benefit from cheaper prices. However, we recognise that whilst shopping around can bring benefits to those who do it, it does create differences between new customer premiums and subsequent renewal premiums.

The Group has taken several steps to tackle this issue in recent years. In 2016 we backed the Association of British Insurers' and the British Insurance Brokers' Association's Code of Good Practice to ensure that our people were trained to identify potential vulnerable consumers. We believe that renewal premiums should not become excessive over time so we put in place checks and balances for our long-standing customers. Increasing numbers of long-standing customers have seen their renewal premium either frozen or reduced as a result. This year we welcomed the Association of British Insurers' principles which are intended to help embed best practice across the industry.

Find out more in our Market overview on page 18

In-car technology

The automotive industry is undergoing dramatic change with improvements in in-car technology and the advent of electric, connected and autonomous vehicles. We are embracing these changes and the opportunities they may present for us to evolve our products. We are maintaining our industry-leading position through our partnerships with MOVE_UK in Greenwich and our participation in StreetWise, which aims to put driverless cars on the streets of Croydon in 2019. We also continue to work with motor manufacturers such as Volkswagen, Peugeot, Citroën and Tesla, evolving our products to match their customers' needs.

Creating value for our stakeholders

Our multi-brand, multi-product and multi-channel business offers different propositions to maximise choice for customers. We believe this approach enables us to provide good value for customers and sustainable returns for our shareholders.

Our core strengths

Customer focus
Customers are at the heart of everything we do. Our brands, products and distribution channels aim to make insurance much easier and better value for our customers.

Talented people
We invest in our people, encouraging everyone to aim higher. Our talented people constantly strive to improve and innovate to exceed the current and future expectations of our customers.

Brand power
Our well-known and trusted brands offer customers decades of experience, knowledge and service. The scale of being Britain's leading motor insurer and one of its leading home insurers[1] gives us a platform for product development.

Data and technology
Continuing our history of disrupting the insurance market, we are harnessing the power of technology and data to make life easier for both our customers and our people.

Capital and financial strength
Our cash-generative business model underpinned by proven underwriting discipline, claims excellence and cost control helps us to meet our customers' needs whilst targeting sustainable returns for our shareholders.

Note:
1. Measured by in-force policies (see page 7).

Find out more on pages 19 – 21

Our diverse proposition

We reach diverse customers by offering a range of products through many routes to market.

Eight brands

so that our customers can choose the proposition that suits them

Four segments

representing a range of products and services

Multiple channels

so that customers can choose how they wish to engage with us

Direct
Price comparison websites
Partnerships

Reinvest in the business

Find out more on pages 4 – 9

How we generate returns

We target sustainable returns for our shareholders through a combination of investing in future capabilities, improving efficiency and careful risk management.

Pricing

We seek to ensure our prices reflect the risks being underwritten by using data and actuarial techniques.

Claims

Our new propositions, such as Fast Response (see page 41) and our expanded network of accident repair centres delivering our seven day repair proposition (see page 21), not only get customers' lives back on track quickly but also aim to deliver high operating efficiency resulting in excellent claims cost control.

Cost control

Once again, we reduced our expense ratio during 2018, absorbing our investment in future capability. We aim to continue to make progress against our strategic initiatives with a focus on cost and efficiency.

Investments

As we gather premiums and provide for future claims payments we use these assets to invest in a diversified investment portfolio.

Risk framework

The Board has an established risk management model that separates responsibility into 'Three Lines of Defence' (see page 44 for more details).

Find out more on pages 26 – 37

Sustainable value

Our objectives are to create value for all our stakeholders, putting our customers first and investing in our people, to support the communities we live and work in, and to generate sustainable profits for our shareholders.

Customers

Net Promoter Score

145.6pts

Employees

Engagement

81%

Communities

Percentage of staff who fundraised or volunteered on the Group's time

28%

Shareholders

Dividend per share

29.3p

Dividends

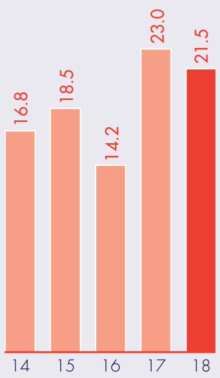
Premiums − Net claims − Costs + Investment and other income = Profit

Find out more on pages 24 – 25

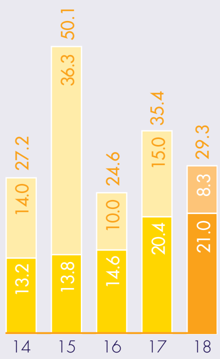
Delivering strong performance

These key performance indicators assess our performance against our strategy.

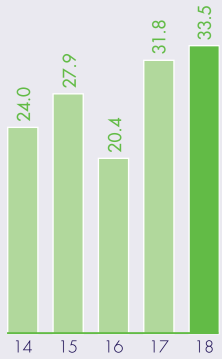
Return on tangible equity[1,2] (%)



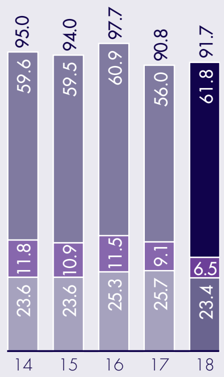
Dividend per share (pence)



Basic earnings per share (pence)



Combined operating ratio[2] (%)



	Return on tangible equity	Dividend per share	Basic earnings per share	Combined operating ratio
Definition	The return generated on the capital that shareholders have in the business. This is calculated by dividing adjusted earnings by average tangible equity.	The amount of cash paid to shareholders from the Group's retained profits. (See page 26 for dividend breakdown).	This is calculated by dividing the earnings attributable to shareholders by the weighted average number of Ordinary Shares in issue.	A measure of financial year underwriting profitability. A Combined operating ratio ("**COR**") of less than 100% indicates profitable underwriting. In addition to net claims, expense and commission ratios measure the cost of doing business and the COR is the sum of these costs divided by net earned premium, excluding instalment and other operating income and investment return.
Aim	We aim to achieve at least a 15% RoTE per annum over the long term.	We aim to grow the regular dividend in line with business growth. Additionally, we look to return any capital to shareholders which is expected to be surplus to our requirements for a prolonged period.	We have not set a target. However, growing earnings per share is considered an indicator of a healthy business.	We aim to make an underwriting profit. For 2019, we expect to achieve a COR in the range of 93% to 95% normalised for weather.
Performance	See Finance review page 31	See Finance review page 32	See Finance review page 31	See Finance review page 29
Link to Directors' remuneration	We base the LTIP awards partly on RoTE over a three-year performance period. See page 90	We base LTIP awards partly on relative total shareholder return performance, which includes dividends. Directors also receive dividends on their beneficial shareholdings and accrue these on unvested LTIP awards. See page 90	This is a broad measure of earnings and reflects the results of the Group after tax. We base part of the AIP awards on profit before tax and earnings per share is closely linked to this. See page 89	We base part of the AIP awards on profit before tax. COR is closely linked to this. See pages 89 and 96

Notes:
1. See glossary on pages 191 to 192 and alternative performance measures in Appendix A on pages 193 to 194.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data for 2017 has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.
3. Estimates based on the Group's solvency II partial internal model for 2016 to 2018. Solvency capital coverage based on the standard formula for 31 December 2015.

Changes to our KPIs in 2018

Our metrics are reviewed annually and updated as appropriate to ensure they remain an effective measure of delivery against our objectives. For 2018, the review of these metrics resulted in the following changes:

- Combined operating ratio has been split into its loss ratio, commission ratio and expense ratio elements to give greater clarity of its composition
- Employee engagement has been added in recognition of the importance of our people in meeting our strategic objectives
- A five-year view, where possible, was chosen to demonstrate our track record of performance

Key for combined operating ratio

Expense ratio   Commission ratio   Loss ratio

Key for dividend per share

Ordinary   Special

Solvency capital ratio[3] (%)

A risk-based measure expressing the level of capital resources held as a percentage of the level of capital that is required under solvency II.

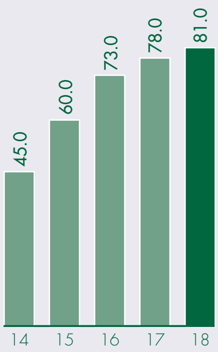
We target a solvency capital ratio in the range of 140% to 180%.

See Finance review page 32

Risk management within risk appetite, which includes an assessment of capital strength, and acts as a gateway for the AIP awards and underpin for LTIP awards.

See pages 89 and 90

Employee engagement (%)



Engagement is about being proud to work for Direct Line Group and helping us to succeed. It means that employees are not just happy or satisfied, but doing something to help us achieve our company goals.

To make the Group best for employees and best for our customers. We gauge employee engagement through our employee opinion survey and we aim to improve this year on year.

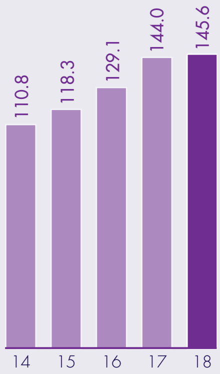
See People and culture page 56

The AIP awards include a weighting to a balance of employee metrics, including engagement.

See pages 89 and 98

Net promoter score[4]

Direct Line Brand (points)



Net promoter score ("NPS") is an index that measures the willingness of customers to recommend products or services to others. It is used to gauge customers' overall experience with a product or service, and customers' loyalty to a brand.

The launch of our customer experience strategy, along with a new transactional feedback tool and improved propositions have increased our overall brand score.

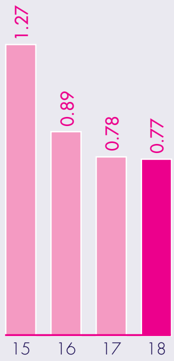
Customer claims experience programmes and improved propositions have contributed to an increase in our overall brand score.

The AIP awards include a weighting to a balance of customer metrics, including NPS.

See pages 89 and 97

Customer complaints[5]

Principal underwriter[6] (%)



The number of complaints we received during the year as a proportion of the average number of in-force policies.

This measure indicates the level of customer service we provide. We aim to improve this over time.

While the proportion of complaints received reduced compared to 2017 we recognise we have more to do to reduce these.

The AIP awards include a weighting to a balance of customer metrics, including complaints.

See pages 89 and 97

4. On an aggregated 12-month rolling basis, with 2013 rebased to 100.
5. FCA complaints reporting requirements have changed for periods after 29 June 2016. Before 29 June 2016, only complaints resolved after two business days were classed as FCA reportable. From July 2016 all complaints resolved are classed as FCA reportable.
6. For the Group's principal underwriter, U K Insurance Limited.

Strong results in a competitive market

Financial highlights

- Direct own brands premium up 1.8% compared to 2017, driven by growth across all segments. Total Group premium reduced by 5.3% year on year, as a result of the exit from Nationwide and Sainsbury's[1] Home partnerships.
- Operating profit decreased by £41.1 million compared to 2017, primarily due to reductions in prior-year reserve releases and investment return as expected. Operating profit included a £55 million benefit from moving to an assumed 0% Ogden discount rate (2017: £49 million benefit relating to Ogden).
- Demonstrating the value in the Group's diversified product base, current-year underwriting profitability was stable despite a reversal of the benign motor conditions in 2017. The expense ratio reduced to 23.4%.
- Profit before tax increased by 8.1% to £582.6 million (2017: £539.0 million) as the decrease in operating profit was more than offset by the non-repeat of finance costs in relation to the debt repurchased in 2017.
- Final ordinary dividend of 14.0 pence per share, an increase of 2.9% on 2017. Special dividend of 8.3 pence per share. Total dividends of 29.3 pence per share (2017: total dividends of 35.4 pence per share including a special dividend of 15.0 pence per share).
- Strong capital position with solvency capital ratio of 170% (after proposed dividends) reflecting prudence given current political and economic uncertainties.
- Reiteration of financial targets for 2019 and over the medium term of achieving a combined operating ratio in the range of 93% to 95% normalised for weather. In 2019, targeting operating expenses below £700 million. Reiteration of ongoing target of achieving at least a 15% return on tangible equity.

	FY 2018 £m	FY 2017[2] £m
In-force policies (thousands)	15,032	15,714
Of which: direct own brands (thousands)	7,132	6,909
Gross written premium	3,211.9	3,392.1
Of which: direct own brands	2,223.0	2,184.1
Net earned premium	3,089.5	3,135.0
Underwriting profit	255.1	288.1
Instalment and other operating income	192.0	179.3
Investment return	154.6	175.4
Operating profit	601.7	642.8
Finance costs	(19.1)	(103.8)
Profit before tax	582.6	539.0
Tax	(108.9)	(105.0)
Profit after tax	473.7	434.0
Key metrics		
Current-year attritional loss ratio[3]	72.5%	69.4%
Loss ratio[3]	61.8%	56.0%
Commission ratio[3]	6.5%	9.1%
Expense ratio[3]	23.4%	25.7%
Combined operating ratio[3]	91.7%	90.8%
Return on tangible equity[4]	21.5%	23.0%
Investment income yield[4]	2.5%	2.5%
Net investment income yield[4]	2.0%	2.1%
Investment return yield[4]	2.4%	2.6%
Basic earnings per share (pence)	33.5	31.8
Diluted earnings per share (pence)	33.1	31.5
Return on equity	17.3%	16.6%
Dividend per share[5]		
– interim (pence)	7.0	6.8
– final (pence)	14.0	13.6
– total ordinary (pence)	21.0	20.4
– special (pence)	8.3	15.0
– total (pence)	29.3	35.4

	31 Dec 2018	31 Dec 2017
Net asset value per share (pence)	188.6	198.9
Tangible net asset value per share (pence)	147.0	164.4
Solvency capital ratio[6] post-dividends	170%	165%

Notes:
1. Exit from Sainbury's in respect of new business.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off profits within the Motor segment.
3. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration.
4. See glossary on pages 191 and 192 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.
5. The Group's dividend policy states its expectation that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend and two-thirds will be paid as a final dividend in the second quarter of the following year.
6. Estimates based on the Group's solvency II partial internal model.

Performance

Operating profit

	FY 2018 £m	FY 2017 £m
Underwriting profit	255.1	288.1
Instalment and other operating income	192.0	179.3
Investment return	154.6	175.4
Total operating profit	601.7	642.8
Of which:		
Current-year operating profit	197.3	207.4
Prior-year reserve releases	404.4	435.4

Operating profit decreased by £41.1 million to £601.7 million (2017: £642.8 million) mainly due to a reduction in the underwriting profit and investment return, partly offset by an increase in instalment and other operating income. Overall, current-year operating profit was lower, with a stable current-year combined operating ratio offset by a lower investment return.

Underwriting profit decreased to £255.1 million (2017: £288.1 million) predominantly due to lower prior-year reserve releases of £31.0 million. Increased weather-related claims of £75 million, mainly associated with the major freeze event in Q1 2018 (2017: £13 million weather-related claims), were mostly offset by the non-repeat in 2018 of the £56.9 million impairment charge in 2017 in relation to IT projects.

The current-year attritional loss ratio increased by 3.1 percentage points to 72.5% (2017: 69.4%) as the Group experienced a reversal of the benign motor conditions in 2017 and a reduction in partnership business in Home. This was offset by a 2.6 percentage point reduction in the commission ratio as a result of both lower commission and profit share payments to Home partners, as a result of the exit of the Nationwide and Sainsbury's partnerships and changes to other partnership commissions arrangements. The current-year combined operating ratio was stable.

Effect of Ogden discount rate changes

	FY 2018 Motor £m	FY 2018 Commercial £m	FY 2018 Total £m	FY 2017 Motor £m	FY 2017 Total £m
Prior year	47.9	3.5	51.4	49.0	49.0
Current year	2.7	0.7	3.4	–	–
Total	50.6	4.2	54.8	49.0	49.0

Following Royal Assent of the Civil Liability Act 2018, which introduced a new framework for setting the personal injury discount rate, the Group reviewed the Ogden discount rate for reserves for large bodily injury claims and selected an assumed rate of 0% for reserving purposes. This has resulted in a release of £54.8 million in 2018 and this release was split across the Motor and Commercial segments. Given the Group's lower reinsurance retention in recent years, the majority of the reserve release related to prior years. In 2017, the Motor segment benefited from a reserve release of £49.0 million resulting from a lower than expected increase in claims costs following the change in the Ogden discount rate to minus 0.75%.

Instalment and other operating income increased to £192.0 million (2017: £179.3 million) and included a £9.6 million gain on sale of a property in Bristol.

Investment return decreased to £154.6 million (2017: £175.4 million) primarily due to a £7.9 million reduction year on year in investment income as a result of lower assets under management and a £12.9 million reduction year on year in realised and unrealised gains.

In-force policies and gross written premium

In-force policies (thousands)

At	31 Dec 2018	31 Dec 2017
Own brands	3,950	3,845
Partnerships	144	174
Motor	4,094	4,019
Own brands	1,789	1,794
Partnerships (excluding Nationwide and Sainsbury's)	803	823
Partnerships (Nationwide and Sainsbury's)	59	631
Home	2,651	3,248
Rescue	3,491	3,591
Travel	3,759	3,853
Pet	156	162
Other personal lines	126	133
Rescue and other personal lines	7,532	7,739
Of which: Green Flag direct	894	802
Direct Line for Business	499	468
NIG and other	256	240
Commercial	755	708
Total in-force policies	15,032	15,714
Of which: direct own brands	7,132	6,909

Total in-force policies reduced to 15.0 million (31 December 2017: 15.7 million), primarily due to lower partner volumes in Home, following the exit from the Nationwide and Sainsbury's partnerships, and reductions in Rescue and other personal lines, as a result of lower packaged bank account volumes. Own brands in-force policies grew to 7.1 million (31 December 2017: 6.9 million) with growth in Motor, Green Flag and Direct Line for Business, which partly offset the overall reduction.

Gross written premium

	FY 2018 £m	FY 2017 £m
Own brands	1,608.8	1,590.9
Partnerships	62.4	79.5
Motor	1,671.2	1,670.4
Own brands	412.6	409.7
Partnerships (excluding Nationwide and Sainsbury's)	181.7	195.6
Partnerships (Nationwide and Sainsbury's)	12.6	193.8
Home	606.9	799.1
Rescue	163.4	161.3
Travel	143.9	143.4
Pet	72.4	74.8
Other personal lines	43.1	41.6
Rescue and other personal lines	422.8	421.1
Of which: Green Flag direct	69.6	60.9
Direct Line for Business	132.0	122.6
NIG and other	379.0	378.9
Commercial	511.0	501.5
Total gross written premium	3,211.9	3,392.1
Of which: direct own brands	2,223.0	2,184.1

Gross written premium of £3,211.9 million (2017: £3,392.1 million) decreased by 5.3% primarily due to the exit from the Nationwide and Sainsbury's partnerships in Home. Direct own brands gross written premium of £2,223.0 million (2017: £2,184.1 million) grew by 1.8%.

Underwriting profit and combined operating ratio

	FY 2018	FY[1] 2017
Underwriting profit (£ million)	255.1	288.1
Loss ratio	61.8%	56.0%
Commission ratio	6.5%	9.1%
Expense ratio	23.4%	25.7%
COR	91.7%	90.8%

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

The Group's combined operating ratio of 91.7% (2017: 90.8%) increased by 0.9 percentage points primarily due to a higher loss ratio which was partly offset by improvements in commission and expense ratios. Weather returned to close to normal levels in 2018 after a benign 2017 and this offset the non-repeat in 2018 of the £56.9 million non-cash impairment charge incurred in 2017. Normalised for weather and adjusted for the Ogden discount rate change, the combined operating ratio was approximately 93.5%, towards the lower end of the Group's medium-term target of 93% to 95%.

The loss ratio was 5.8 percentage points higher at 61.8% (2017: 56.0%) and reflected lower prior-year reserve releases, increases in Home and Commercial loss ratios due to the major freeze event in Q1 2018 and a reversal of benign motor conditions in 2017.

The expense ratio improved by 2.3 percentage points to 23.4% (2017: 25.7%), as the Group continued to reduce its operating expenses (0.5 percentage points excluding the impact of impairments in 2017). The reduction in the commission ratio of 2.6 percentage points primarily reflected both lower commissions and profit share payments to Home partners, as a result of the exit of the Nationwide and Sainsbury's partnerships, and changes to other partnership commissions arrangements. The remaining premium from these partnerships was substantially earned in 2018 and consequently the commission ratio is expected to reduce again in 2019 albeit at a significantly slower rate. In subsequent years the direction of the commission ratio will be dependent on the Group's partnership activities.

Ratio analysis by division

	Notes	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
For the year ended 31 December 2018						
Net earned premium	4	1,541.8	667.8	414.7	465.2	3,089.5
Net insurance claims	4	980.0	413.3	277.2	241.3	1,911.8
Prior-year reserve releases	33	276.3	32.6	16.1	79.4	404.4
Major weather events		n/a	(65.0)	n/a	(10.0)	(75.0)
Attritional net insurance claims		1,256.3	380.9	293.3	310.7	2,241.2
Loss ratio – current-year attritional		81.5%	57.0%	70.7%	66.8%	72.5%
Loss ratio – prior-year reserve releases		(17.9%)	(4.9%)	(3.9%)	(17.1%)	(13.1%)
Loss ratio – major weather events[1]		n/a	9.7%	n/a	2.1%	2.4%
Loss ratio – reported	4	63.6%	61.8%	66.8%	51.8%	61.8%
Commission ratio	4	2.0%	9.4%	4.6%	18.9%	6.5%
Expense ratio	4	23.3%	22.4%	23.8%	24.8%	23.4%
COR	4	88.9%	93.6%	95.2%	95.5%	91.7%
Current-year COR		106.8%	98.5%	99.1%	112.6%	104.8%
For the year ended 31 December 2017[2]						
Net earned premium	4	1,470.6	790.5	417.6	456.3	3,135.0
Net insurance claims	4	852.9	400.5	273.3	227.5	1,754.2
Prior-year reserve releases	33	318.6	23.7	6.8	86.3	435.4
Major weather events		n/a	(13.0)	n/a	n/a	(13.0)
Attritional net insurance claims		1,171.5	411.2	280.1	313.8	2,176.6
Loss ratio – current-year attritional		79.7%	52.0%	67.1%	68.8%	69.4%
Loss ratio – prior-year reserve releases		(21.7%)	(3.0%)	(1.7%)	(18.9%)	(13.9%)
Loss ratio – major weather events[1]		n/a	1.6%	n/a	n/a	0.4%
Loss ratio – reported	4	58.0%	50.6%	65.4%	49.9%	56.0%
Commission ratio	4	2.5%	17.7%	5.5%	19.1%	9.1%
Expense ratio	4	29.3%	21.1%	23.4%	24.4%	25.7%
COR	4	89.8%	89.4%	94.3%	93.4%	90.8%
Current-year COR		111.5%	92.4%	96.0%	112.3%	104.7%

Notes:
1. Home and Commercial claims for major weather events, including inland and coastal flooding and storms.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

The movement in the current-year attritional loss ratio is an indicator of underlying accident year performance as it excludes prior-year reserve releases and claims costs from major weather events. The Group's current-year attritional loss ratio of 72.5% increased by 3.1 percentage points compared to 2017 primarily due to a change in business mix and a reversal of benign conditions experienced in 2017 in Motor.

Prior-year reserve releases continued to be significant at £404.4 million (2017: £435.4 million), were equivalent to 13.1% of net earned premium (2017: 13.9%) and were concentrated towards more recent accident years. Reserve releases in 2018 included a £51.4 million Ogden rate-related prior-year reserve release (2017: £49.0 million release). Assuming current claims trends continue, prior-year reserve releases are expected to reduce further in future years, although they are expected to remain a significant contribution to profits.

The Group's current-year combined operating ratio remained broadly steady at 104.8% (2017: 104.7%) as increases in attritional loss ratios were offset by reductions in commission and expense ratios.

Operating expenses

	FY 2018 £m	FY 2017 £m
Staff costs[1]	269.9	280.1
Other operating expenses[1,2]	253.3	273.6
Marketing	121.2	113.7
Amortisation and impairment of other intangible assets[3]	46.7	111.0
Depreciation	31.1	27.9
Total operating expenses	722.2	806.3

Notes:
1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. Other operating expenses include IT costs, insurance levies, professional fees and property costs.
3. Amortisation and impairment of other intangible assets includes a £1.5 million impairment charge for year ended 31 December 2018 (2017: £56.9 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

Operating expenses reduced by £84.1 million to £722.2 million (2017: £806.3 million) resulting in an expense ratio of 23.4% (2017: 25.7%). Excluding an impairment of intangible assets of £56.9 million in 2017, operating expenses reduced by 3.6% as reductions in staff costs and other operating expenses were partially offset by an increase in marketing spend in Motor and Commercial to drive brand awareness. The Group continued to invest in its significant IT programme and operational efficiency improvements while supporting business growth and investment in future capability.

The Group will apply IFRS 16 'Leases' from 1 January 2019. If the Group had applied this standard in 2018, the impact would have been a reduction in operating expenses of approximately £5 million and an increase in finance costs of approximately £7 million.

In 2019, the Group expects to make further progress in reducing operating costs and is targeting operating expenses below £700 million.

Instalment and other operating income

	Note	FY 2018 £m	FY 2017 £m
Instalment income		119.9	116.4
Other operating income:			
Vehicle replacement referral income	7	17.2	16.9
Revenue from vehicle recovery and repair services	7	11.7	11.3
Legal services income	7	11.2	11.0
Other income	7	32.0	23.7
Other operating income	7	72.1	62.9
Total instalment and other operating income		192.0	179.3

Instalment and other operating income increased by £12.7 million, with increased instalment income of £3.5 million due to higher Motor gross written premium partly offset by a reduction in Home due to the exit from Nationwide and Sainsbury's partnerships. Other operating income increased by £9.2 million, primarily relating to a one-off gain on disposal of the Bristol property of £9.6 million.

Investment return

	Note	FY 2018 £m	FY 2017 £m
Investment income		159.2	167.1
Hedging to a sterling floating rate basis		(30.8)	(27.0)
Net investment income		128.4	140.1
Net realised and unrealised gains excluding hedging		26.2	35.3
Total investment return	6	154.6	175.4

Investment yields

	FY 2018	FY 2017
Investment income yield[1]	2.5%	2.5%
Net investment income yield[1]	2.0%	2.1%
Investment return yield[1]	2.4%	2.6%

Note:
1. See glossary on pages 190 and 191 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.

Total investment return decreased by £20.8 million to £154.6 million (2017: £175.4 million). This was due to a reduction in investment income primarily as a result of lower assets under management, and a reduction in realised and unrealised gains excluding hedging which was predominantly driven by a reduction in investment property valuations (2018: £12.7 million, 2017: £21.6 million) and debt security disposals.

The investment income yield for 2018 remained stable at 2.5% (2017: 2.5%). The net investment income yield was lower at 2.0% (2017: 2.1%) as a result of increased hedging costs.

Reconciliation of operating profit

	FY 2018 £m	FY[1] 2017 £m
Motor	415.2	396.4
Home	83.1	128.8
Rescue and other personal lines	43.4	43.6
Commercial	60.0	74.0
Operating profit	601.7	642.8
Finance costs	(19.1)	(103.8)
Profit before tax	582.6	539.0
Tax	(108.9)	(105.0)
Profit after tax	473.7	434.0

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

Operating profit by segment

All divisions were profitable in 2018 with Motor increasing profits by £18.8 million compared to 2017. Home reported reduced operating profits primarily due to the major freeze event in Q1 2018. Commercial also experienced higher weather costs in 2018 although attritional claims performance improved. Rescue and other personal lines reported slightly lower profits. Rescue operating profit of £40.2 million (2017: £43.5 million) is included in the Rescue and other personal lines result.

Finance costs

Finance costs reduced to £19.1 million (2017: £103.8 million), with 2017 including costs and interest associated with the repurchase of £250 million nominal value of the subordinated debt in December 2017.

Effective corporation tax rate

The effective tax rate for 2018 was 18.7% (2017: 19.5%), which was lower than the standard UK corporation tax rate of 19.0% (2017: 19.25%) driven primarily by tax relief for the Tier 1 coupon payments offset by disallowable expenses.

Profit for the year and return on tangible equity[1]

Profit for the year was £473.7 million (2017: £434.0 million) as the decrease in operating profit was more than offset by the non-repeat of finance costs in relation to the debt repurchase in 2017.

Return on tangible equity decreased to 21.5% (2017: 23.0%) due primarily to a £31.5 million decrease in adjusted profit after tax to £457.1 million (2017: £488.6 million). Profit after tax in 2018 was adjusted for coupon payments in respect of Tier 1 notes, while profit after tax in 2017 was adjusted to add back finance costs for the one-off subordinated debt buy-back.

Earnings per share

Basic earnings per share increased by 5.3% to 33.5 pence (2017: 31.8 pence). Diluted earnings per share increased by 5.1% to 33.1 pence (2017: 31.5 pence) mainly reflecting an increase in profit after tax.

Cash flow

The Group's cash and cash equivalents decreased by £212.1 million during the year (2017: £193.7 million increase), to £1,092.4 million (31 December 2017: £1,304.5 million).

Operating activities before investment of insurance assets generated a cash inflow of £4.2 million (2017: £204.0 million generated). The decrease primarily reflected a reduction in insurance liabilities and trade payables partially offset by a reduction in insurance and other receivables.

Investment of insurance assets generated a cash inflow of £468.1 million (2017: inflow of £341.9 million). The increased inflow of £126.2 million is primarily due to the proceeds on disposal of financial investments.

Investing activities generated a cash outflow of £141.8 million (2017: outflow of £95.3 million) primarily due to an increase in the purchase of intangible assets, which was partially offset by lower tangible asset purchases and proceeds from the asset held for sale.

Financing activities generated a cash outflow of £542.6 million (2017: outflow of £256.9 million). The increased outflow primarily reflected an increase in dividends and appropriations paid in the year.

Net asset value

At 31 December	Note	2018 £m	2017 £m
Net assets[1]	16	2,573.1	2,715.1
Goodwill and other intangible assets	16	(566.8)	(471.1)
Tangible net assets	16	2,006.3	2,244.0
Closing number of Ordinary Shares (millions)	16	1,364.6	1,365.1
Net asset value per share (pence)	16	188.6	198.9
Tangible net asset value per share (pence)	16	147.0	164.4

The net assets at 31 December 2018 decreased to £2,573.1 million (31 December 2017: £2,715.1 million) and tangible net assets decreased to £2,006.3 million (31 December 2017: £2,244.0 million). These decreases mainly reflected the payment of the 2017 final and special dividends, a reduction in the available-for-sale reserves due to rising market yields and an increase in expenditure on intangible assets as the Group continued to invest in the business, partially offset by the 2018 retained profit.

Note:
1. See glossary on pages 191 and 192 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.

Balance sheet management

Capital management and dividend policy

The Group aims to manage its capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, rating agency and policyholder requirements.

The Group aims to grow its regular dividend in line with business growth.

Where the Board believes that the Group has capital which is expected to be surplus to the Group's requirements for a prolonged period, it would intend to return any surplus to shareholders. In normal circumstances, the Board expects that a solvency capital ratio around the middle of its risk appetite range of 140% to 180% of the Group's solvency capital requirement ("SCR") would be appropriate and it will therefore take this into account when considering the potential for special distributions.

In the normal course of events the Board will consider whether or not it is appropriate to distribute any surplus capital to shareholders once a year, alongside the full year results.

The Group expects that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend, and two-thirds will be paid as a final dividend in the second quarter of the following year. The Board may revise the dividend policy from time to time. The Company may consider a special dividend and/or a repurchase of its own shares to distribute surplus capital to shareholders.

The Board has recommended a final dividend of 14.0 pence per share (2017: 13.6 pence), an increase of 0.4 pence per share (2.9%), in line with business growth. This reflects the Board's continued confidence in the Group's earnings and the progress the business continued to make.

The Board has also declared a special dividend of 8.3 pence per share. After both dividends the solvency capital ratio will be 170% as at 31 December 2018.

The Board has taken into account the high level of political and economic uncertainty, including in relation to Brexit, and considers it appropriate for the time being to maintain a prudent solvency capital ratio towards the upper end of the solvency capital ratio risk appetite range of 140% to 180%. The Board will keep this position under review as it monitors developments in the political and economic environment. In normal circumstances, the Board expects the Group to operate around the middle of its solvency capital ratio risk appetite range.

The final dividend and special dividend will be paid on 16 May 2019 to shareholders on the register on 5 April 2019. The ex-dividend date will be 4 April 2019.

Capital analysis

The Group is regulated under solvency II requirements by the PRA on both a Group basis and for the Group's principal underwriter, U K Insurance Limited. In its results, the Group has estimated its solvency II own funds, SCR and solvency capital ratio as at 31 December 2018.

Capital position

At 31 December 2018, the Group held a solvency II capital surplus of approximately £0.89 billion above its regulatory capital requirements, which was equivalent to an estimated solvency capital ratio of 170%, post the proposed final and special dividends.

The Group's SCR and solvency capital ratio are as follows:

At 31 December	2018	2017[1]
Solvency capital requirement (£ billion)	1.26	1.39
Capital surplus above solvency capital requirement (£ billion)	0.89	0.91
Solvency capital ratio post-dividend	170%	165%

Movement in capital surplus

	2018 £bn	2017[1] £bn
Capital surplus at 1 January	0.91	0.91
Capital generation excluding market movements	0.47	0.54
Market movements	(0.06)	–
Capital generation	0.41	0.54
Change in solvency capital requirement	0.13	0.01
Surplus generation	0.54	0.55
Capital expenditure	(0.15)	(0.10)
Management capital action	–	0.03
Capital distribution – ordinary dividends[2]	(0.30)	(0.28)
Capital distribution – special dividends[2]	(0.11)	(0.20)
Net surplus movement	(0.02)	–
Capital surplus at 31 December	0.89	0.91

Notes:
1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.
2. Foreseeable dividends included above are adjusted to exclude the expected dividend waivers in relation to shares held by the employee share trusts, which are held to meet obligations arising on the various share option awards.

During 2018, the Group's own funds decreased from £2.30 billion to £2.15 billion. The Group generated £0.41 billion of solvency II capital offset by £0.15 billion of capital expenditure and capital distribution of £0.41 billion for the 2018 dividend. The increased capital expenditure reflects the significant investment the Group is making in building future capability including the development of the latest generation core personal lines IT systems. In 2019, the level of expenditure is expected to be approximately £175 million, reducing to less than £150 million in 2020. Thereafter, expenditure levels are expected to reduce further.

Change in solvency capital requirement

	2018 £bn
Solvency capital requirement at 1 January	1.39
Model and parameter changes	(0.07)
Exposure changes	(0.06)
Solvency capital requirement at 31 December	1.26

The Group's SCR has reduced by £0.13 billion in the year. Model and parameter changes reduced the SCR by £0.07 billion. Exposure changes, as a result of the exited Home partnerships, a reduction in solvency II technical provisions including an assumed change in the Ogden discount rate to 0%, and lower assets under management, led to a reduction in the SCR of £0.06 billion.

Scenario and sensitivity analysis

The following table shows the impact on the Group's estimated solvency capital ratio in the event of the following scenarios as at 31 December 2018. The impact on the Group's solvency capital ratio arises from movements in both the Group's solvency capital requirement and own funds.

	Impact on solvency capital ratio	
Scenario	31 Dec 2018	31 Dec 2017
Motor small bodily injury deterioration equivalent to accident years 2008 and 2009	(7pts)	(7pts)
One-off catastrophe loss equivalent to the 1990 storm	(8pts)	(9pts)
One-off catastrophe loss based on extensive flooding of the River Thames	(8pts)	(9pts)
Change in reserving basis for PPOs to use a real discount rate of minus 1%[1]	(10pts)	(13pts)
100bps increase in credit spreads[2]	(11pts)	(11pts)
100bps decrease in interest rates with no change in the PPO real discount rate	(1pt)	(3pts)

Notes:
1. The PPO real discount rate used is an actuarial judgement which is reviewed annually based on the economic outlook for wage inflation relative to the European Insurance and Occupational Pensions Authority discount rate curve.
2. These sensitivities only include the assessed impact of the above scenarios in relation to AFS investments.

Own funds

The following table splits the Group's own funds by tier on a solvency II basis.

At 31 December	2018 £bn	2017[1] £bn
Tier 1 capital before foreseeable dividends	1.76	2.04
Foreseeable dividends	(0.31)	(0.39)
Tier 1 capital – unrestricted	1.45	1.65
Tier 1 capital – restricted	0.35	0.35
Tier 1 capital	1.80	2.00
Tier 2 capital – subordinated debt	0.26	0.26
Tier 3 capital – deferred tax	0.09	0.04
Total own funds	2.15	2.30

Note:
1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.

Tier 1 capital after foreseeable dividends represents 84% of own funds and 143% of the estimated SCR. Tier 2 capital relates solely to the Group's £0.26 billion subordinated debt. The amount of Tier 2 and Tier 3 capital permitted under the solvency II regulations is 50% of the Group's SCR and of Tier 3 alone it is less than 15%. Therefore, the Group currently has no ineligible capital. The requirement that Tier 1 restricted capital should not exceed 20% of total Tier 1 capital, when satisfying the requirement that eligible Tier 1 items should be at least 50% of SCR, is not applicable to the Group.

The special dividend will be payable from surplus capital generated from continuing operations of the Group.

Reconciliation of IFRS shareholders' equity to solvency II own funds

At 31 December	2018 £bn	2017[1] £bn
Total shareholders' equity	2.57	2.72
Goodwill and intangible assets	(0.57)	(0.47)
Change in valuation of technical provisions	(0.15)	(0.13)
Other asset and liability adjustments	(0.09)	(0.08)
Foreseeable dividends	(0.31)	(0.39)
Tier 1 capital – unrestricted	1.45	1.65
Tier 1 capital – restricted	0.35	0.35
Tier 1 capital	1.80	2.00
Tier 2 capital – subordinated debt	0.26	0.26
Tier 3 capital – deferred tax	0.09	0.04
Total own funds	2.15	2.30

Note:
1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.

Leverage

The Group's financial leverage increased by 0.7 percentage points, but remained conservative at 19.1% (2017: 18.4%). The increase was primarily due to the reduction in shareholders' equity. While the Tier 1 notes issued during 2017 are presented as equity in the balance sheet, the Group considers this to be part of its total leverage.

At 31 December	2018 £m	2017 £m
Shareholders' equity	2,573.1	2,715.1
Tier 1 notes	346.5	346.5
Financial debt – subordinated debt	259.5	264.7
Total capital employed	3,179.1	3,326.3
Financial-leverage ratio[1]	19.1%	18.4%

Note:
1. Total IFRS financial debt and Tier 1 notes as a percentage of total IFRS capital employed.

Credit ratings

Standard & Poor's and Moody's Investors Service provide insurance financial-strength ratings for U K Insurance Limited, the Group's principal underwriter. U K Insurance Limited is currently rated 'A' (strong) with a stable outlook by Standard & Poor's, and 'A2' (good) with a positive outlook by Moody's.

Reserving

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling costs. The Group considers the class of business, the length of time to notify a claim, the validity of the claim against a policy, and the claim value. Claims reserves could settle across a range of outcomes, and settlement certainty increases over time. However, for bodily injury claims the uncertainty is greater due to the length of time taken to settle these claims. The possibility of annuity payments for injured parties also increases this uncertainty.

The Group seeks to adopt a conservative approach to assessing liabilities, as evidenced by the favourable development of historical claims reserves. Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is set by reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other short and long-term risks not reflected in the actuarial inputs, as well as management's view on the uncertainties in relation to the actuarial best estimate.

The most common method of settling bodily injury claims is by a lump sum paid to the claimant and, in the cases where this includes an element of indemnity for recurring costs such as loss of earnings or ongoing medical care, settlement calculations have reference to a standardised annuity factor at a discount rate normally referred to as the Ogden discount rate. The Ogden discount rate was 2.5% from 2001 until 2017, when it was changed to minus 0.75% based on a 3-year average of yields on index-linked government securities, in line with case law that claimants were entitled to invest their lump sum in a way which was very low or even zero risk. The Civil Liability Act 2018 changes this approach and instead requires the Government to reset the Ogden discount rate by reference to low risk rather than very low or zero risk investments. The process is due to conclude in 2019, but there is considerable uncertainty about its outcome and the date from which a new rate will apply.

The Group will continue to exercise judgement around the Ogden discount rate used in its reserves. Risks and uncertainties here are significant but the move to introduce additional asset classes into the assumed claimant portfolio points towards a higher rate than minus 0.75%. The Group has therefore made a judgement that it is likely that the Ogden discount rate will change and has selected an estimate of 0% to value its lump sum bodily injury reserves. An allowance for further movements in the Ogden rate is made within the Group's solvency II balance sheet and capital requirements. Details of the IFRS sensitivity analysis to the assumed Ogden discount rate are shown overleaf.

The Group's prior-year reserve releases were £404.4 million (2017: £435.4 million) with good experience in large bodily injury claims being a key contributor.

Looking forward, the Group expects to continue setting its initial management best estimate conservatively. Assuming current claims trends continue, the contribution from prior-year reserve releases will reduce over time, although it is expected to remain significant.

Claims reserves net of reinsurance

At 31 December	2018 £m	2017[1] £m
Motor	1,946.4	2,187.3
Home	323.8	293.3
Rescue and other personal lines	89.1	85.6
Commercial	541.4	578.3
Total	2,900.7	3,144.5

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include Run-off segment profits within the Motor segment.

Sensitivity analysis – the discount rate used in relation to PPOs and changes in the assumed Ogden discount rate

The table below provides a sensitivity analysis of the potential net impact of a change in a single factor (the discount rate used for periodic payment orders ("**PPOs**") and separately the Ogden discount rate) with all other assumptions left unchanged. Other potential risks beyond the ones described could have an additional financial impact on the Group.

At 31 December	Increase/(decrease) in profit before tax [1,2] 2018 £m	2017 £m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	50.7	54.6
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(70.1)	(75.1)
Ogden discount rate[4]		
Impact of the Group reserving at a discount rate of 1% compared to 0% (2017: 0% compared to minus 0.75%)	56.2	68.4
Impact of the Group reserving at a discount rate of minus 1% compared to 0% (2017: minus 1.5% compared to minus 0.75%)	(76.3)	(102.9)

Notes:
1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated as the direct impact of the change in the real discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated as the direct impact of a permanent change in the discount rate with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis, as is the case at the year ended 31 December 2018. This is intended to ensure that reserves are appropriate for current and potential future developments.

The sensitivity above is calculated on the basis of a permanent change in the rate used for the actuarial best estimate reserves as at 31 December 2018. It does not take into account a change in the Ogden discount rate setting regime, nor any second order impacts such as those on the Group's PPO assumptions or reinsurance bad debt assumptions.

The reduction in sensitivity to a change in the Ogden discount rate since 31 December 2017 primarily reflects the overall reduction in bodily injury exposures. The reduction in exposure is due to continued positive prior-year development of claims reserves for large bodily injury claims, and a higher proportion of reserves benefiting from a lower reinsurance retention.

Reinsurance

The objectives of the Group's reinsurance strategy are to reduce the volatility of earnings, facilitate effective capital management, and transfer risk outside the Group's risk appetite. This is achieved by transferring risk exposure through various reinsurance programmes:

- Catastrophe reinsurance to protect against an accumulation of claims arising from a natural perils event. The retained deductible is 14.88% of gross earned premium (£126.5 million at 31 December 2018) and cover is placed annually on 1 July up to a modelled 1-in-200 year loss event of 128.88% of gross earned premium (£1,095.5 million at 31 December 2018). At the last renewal, 1 July 2018, approximately 60% of the reinsurance programme was placed on a fixed price basis (reinsurers' rate on line) as the second year of a three-year contract.
- Motor reinsurance to protect against a single claim or an accumulation of large claims which renews on 1 January. The retained deductible is at an indexed level of £1 million per claim, providing a substantial level of protection against large motor bodily injury claims. This programme was renewed on 1 January 2019.
- Commercial property risk reinsurance to protect against large individual claims with a retained deductible of £4.0 million which renews annually on 1 July.

Investment portfolio

The investment strategy aims to deliver several objectives, which are summarised below:

- to ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios
- to match PPO and non-PPO liabilities in an optimal manner
- to deliver a suitable risk-adjusted investment return commensurate with the Group's risk appetite

Asset and liability management

The following table summarises the Group's high-level approach to asset and liability management.

Liabilities	Assets	Characteristics
More than 10 years, for example PPOs	Property and infrastructure debt	Inflation linked or floating
Short and medium term – all other claims	Investment-grade credit, short-term high yield and subordinated financial debt	Key rate duration matched
Tier 1 equity	Investment-grade credit	Fixed
Tier 2 sub-debt (swapped fixed to floating)	Commercial real estate loans and cash	Floating
Surplus – tangible equity	Investment-grade credit, cash and government debt securities	Fixed or floating

Asset allocation and benchmarks

The current strategic asset benchmarks for the Group are detailed in the following table:

At 31 December	Benchmark holding 2018	Actual holding 2018	Benchmark holding 2017	Actual holding 2017
Investment-grade credit	65.0%	58.5%	60.0%	58.1%
High-yield	6.0%	6.4%	6.0%	5.8%
Investment-grade private placements	3.0%	1.6%	4.0%	1.5%
Credit	**74.0%**	**66.5%**	70.0%	65.4%
Sovereign	5.0%	2.6%	8.0%	3.4%
Total debt securities	**79.0%**	**69.1%**	78.0%	68.8%
Infrastructure debt	5.0%	4.7%	5.0%	4.7%
Commercial real estate loans	4.0%	3.3%	3.0%	2.5%
Cash and cash equivalents	7.0%	17.7%	9.0%	19.4%
Investment property	5.0%	5.2%	5.0%	4.6%
Total	**100.0%**	**100.0%**	100.0%	100.0%

Investment holdings and yields – total Group

	2018			2017		
	Allocation (£m)	Income (£m)	Yield (%)	Allocation (£m)	Income (£m)	Yield (%)
Investment-grade credit[1]	3,606.6	99.6	2.7%	3,893.1	109.2	2.8%
High-yield	393.9	18.8	4.8%	388.6	19.7	4.9%
Investment-grade private placements	101.0	2.8	2.7%	103.6	2.4	2.6%
Credit	**4,101.5**	**121.2**	**2.9%**	4,385.3	131.3	3.0%
Sovereign	156.9	2.8	1.5%	224.8	6.2	2.2%
Total debt securities	**4,258.4**	**124.0**	**2.8%**	4,610.1	137.5	3.0%
Infrastructure debt	289.6	6.9	2.3%	316.4	6.8	2.1%
Commercial real estate loans	201.6	6.2	3.7%	169.0	3.7	3.0%
Cash and cash equivalents[2]	1,092.4	6.2	0.5%	1,304.5	2.9	0.2%
Investment property	322.1	15.9	5.1%	309.3	16.2	5.1%
Total Group	**6,164.1**	**159.2**	**2.5%**	6,709.3	167.1	2.5%

Notes:
1. Asset allocation at 31 December 2018 includes investment portfolio derivatives, which have been included and have a mark-to-market asset value of £11.8 million included in investment grade credit (31 December 2017: mark-to-market asset value of £55.1 million). This excludes non-investment derivatives that have been used to hedge interest on subordinated debt and operational cash flows.
2. Net of bank overdrafts: includes cash at bank and in hand and money market funds with no notice period for withdrawal.

At 31 December 2018, total investment holdings of £6,164.1 million were 8.1% lower than at the start of the year reflecting primarily the cash paid in 2018 for dividends and a decline in fair value of debt securities. Total debt securities were £4,258.4 million (31 December 2017: £4,610.1 million), of which 4.6% were rated as 'AAA' and a further 59.3% were rated as 'AA' or 'A'. The average duration at 31 December 2018 of total debt securities was 2.5 years (31 December 2017: 2.3 years).

Tax management

The Board recognises that the Group has an important responsibility to manage its tax position effectively. The Board has delegated day-to-day management of taxes to the Chief Financial Officer and oversight is provided by the Audit Committee.

These arrangements are intended to ensure that the Group: complies with applicable laws and regulations; meets its obligations as a contributor and a collector of taxes on behalf of the tax authorities; and manages its tax affairs efficiently, claiming reliefs and other incentives where appropriate.

Tax authorities

The Group has open and cooperative relationships with the tax authorities with whom it deals in the countries where the Group operates, namely the UK, the Republic of Ireland, South Africa and India.

Tax policy and governance

The Group's tax policy has been reviewed and approved by the Audit Committee. The Group Tax team supports the Chief Financial Officer in ensuring the policy is adhered to at an operational level.

For more information please see our published Group Tax policy on the Group's website at www.directlinegroup.co.uk/en/who-we-are/governance/other-policies.html

Total tax contribution

The Group's direct and indirect tax contribution to the UK Exchequer is significantly higher than the UK corporation tax that the Group pays on its profits. The Group collects taxes relating to employees and customers on behalf of the UK Exchequer and other national governments. It also incurs a significant amount of irrecoverable value added tax relating to overheads and claims.

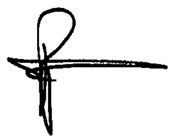
During 2018 the sum of taxes either paid or collected across the Group was £961.7 million. The composition of this between the various taxes borne and collected by the Group is shown below.

Total taxes borne

At 31 December	2018 £m
Current-year corporation tax charge	114.4
Irrecoverable VAT incurred on overheads	90.2
Irrecoverable VAT embedded within claims spend	197.2
Employer's national insurance contribution	39.2
Other taxes	8.7
Total	449.7

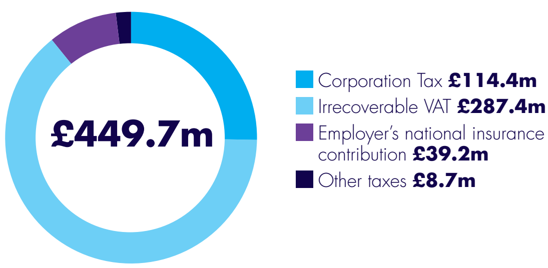
Total taxes collected

At 31 December	2018 £m
Insurance premium tax collected	400.6
VAT collected	12.2
Employees' PAYE and national insurance contribution	99.2
Total	512.0

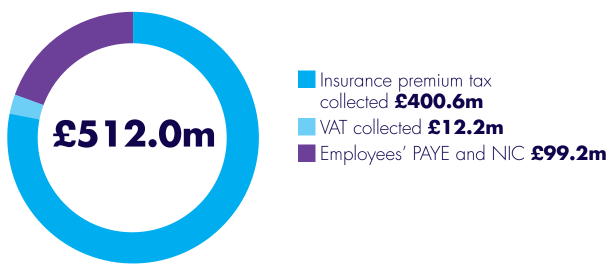


PENNY JAMES
CHIEF FINANCIAL OFFICER

Total taxes borne by tax type (£m)



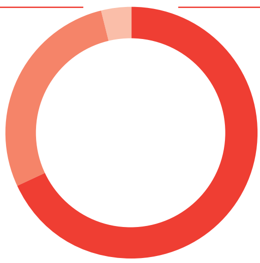
Total taxes collected by tax type (£m)



Motor

- Own brand in-force policies increased by 2.7% with overall growth in in-force policies of 1.9%, up to 4.1 million
- Own brand growth in gross written premium of £17.9 million, overall gross written premium broadly stable
- Operating profit of £415.2 million was £18.8 million higher than prior year primarily due to a non-repeat of 2017's intangible asset impairment of £56.9 million

Gross written premium by channel[1]



In-force policies ('000s)

4,094

(2017: 4,019)

Gross written premium

£1,671.2m

(2017: £1,670.4m)

Operating profit

£415.2m

(2017: £396.4m)

Combined operating ratio

88.9%

(2017: 89.8%)

	2018	2017
In-force policies (thousands)	4,094	4,019
Of which own brands	3,950	3,845
Gross written premium	£1,671.2m	£1,670.4m
Loss ratio	63.6%	58.0%
Commission ratio	2.0%	2.5%
Expense ratio	23.3%	29.3%
Combined operating ratio	88.9%	89.8%
Operating profit	£415.2m	£396.4m

Overview

In 2018, the Group grew its Motor policy count at target margins, in an increasingly competitive market, demonstrating the value that customers place on our brands and propositions.

Whilst the current-year attritional loss ratio was up by 1.8 percentage points, the current-year combined operating ratio was broadly stable (excluding the effect of the £56.9 million impairment of intangible assets in 2017), and operating profit was up 4.7%.

The Group continued its progress with its customer-focused initiatives launched in the year. The Group's Direct Line brand remained attractive as it continued to enhance the propositions and services customers value. The brand launched a new proposition in the first quarter: a 'No Blame' proposition which protects customers from losing their no claim discount for a range of common non-fault claims. A new Motor partnership was signed in 2018 with Volkswagen Insurance Service (Great Britain) Limited.

Performance

The Motor division grew in-force policies by 1.9% to 4.1 million and gross written premium was broadly stable at £1,671.2 million. The growth in in-force policies was across both direct and price comparison website channels, driven by growth in Direct Line and Churchill which showed the value of our multi-brand strategy. While new business volumes fell slightly, retention remained strong year on year across all channels.

Motor average premium[2] fell by 1.0% in 2018. Motor risk-adjusted prices increased by 0.6% in 2018 while risk mix reduced average premiums by 1.5%. The change in risk mix primarily reflected the attractiveness of the Group's free Motor legal protection cover to lower average premium Churchill aggregator customers.

Note:
1. By original channel.
2. Average incepted written premium excluding insurance premium tax for total Motor for the year ended 31 December 2018.

Keeping No Claim Discount for our customers

16,618 customers have benefited from Direct Line's 'No Blame' proposition which provides that a policyholder's No Claim Discount is not affected if their car is damaged in any of these circumstances:

- Potholes or poor road maintenance
- Fire and/or theft of/or from the car
- Hit whilst parked
- Flood
- If you hit or were hit by a wild or domestic animal
- Hit by object or debris (excluding vehicles)

This ensures that our customers are not being punished for something that is not their fault and are able to keep their hard earned no claims discount intact. Just another way that we are making insurance much easier and better value for our customers.

16,618
Customers benefited from 'No Blame' proposition

Our customers said:

I felt valued and that you were on my side

This promise is truly differentiating

The current-year attritional loss ratio in Motor increased by 1.8 percentage points to 81.5% (2017: 79.7%) following a reversal of benign conditions experienced in 2017. The Group observed higher claims frequency in 2018 following an unusually low frequency year in 2017. The Group's long-term view of claims inflation remains within the range of 3% to 5%.

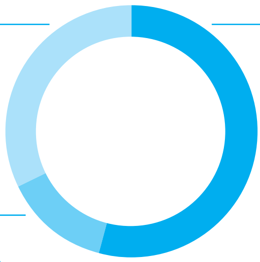
In total, prior-year reserve releases were £42.3 million lower year on year at £276.3 million, and included £47.9 million relating to the change in the assumed Ogden discount rate (2017: £49.0 million release). Bodily injury claims reserves continued to develop favourably.

Motor's reported combined operating ratio improved by 0.9 percentage points to 88.9% (2017: 89.8%). This was primarily as a result of the improvement in the expense ratio, following the non-repeat in 2018 of 2017's impairment of intangible assets.

Home

- Total in-force policies and gross written premium 18.4% and 24.1% lower, respectively, in 2018 following exit of Nationwide and Sainsbury's[1] partnerships
- Own brands in-force policies were broadly stable year-on-year and gross written premium on own brands increased by 0.7%
- Total operating profit was £45.7 million lower than in 2017, reflecting Q1 2018's freeze event

Gross written premium by channel[2]



In-force policies ('000s)

2,651

(2017: 3,248)

Gross written premium

£606.9m

(2017: £799.1m)

Operating profit

£83.1m

(2017: £128.8m)

Combined operating ratio

93.6%

(2017: 89.4%)

	2018	2017
In-force policies (thousands)	2,651	3,248
Of which own brands	1,789	1,794
Gross written premium	£606.9m	£799.1m
Loss ratio	61.8%	50.6%
Commission ratio	9.4%	17.7%
Expense ratio	22.4%	21.1%
Combined operating ratio	93.6%	89.4%
Operating profit	£83.1m	£128.8m

Overview

In 2018, the Group maintained underwriting discipline in a competitive market. The Group maintained strong retention rates, demonstrating the appeal of our brands and propositions. The shift in distribution of Home's business from partners to price comparison websites continued in 2018. Against this backdrop, the Group remained competitive across all channels.

Focusing on propositions that differentiate Home's products, 2018 saw the launch of Direct Line's 'Fast Response'. This proposition sees the Group agreeing an action plan with customers within 24 hours of major water damage.

Performance

In-force policies for Home's own brands were broadly stable compared with 2017 at 1.8 million policies, while partnerships volumes reduced by 40.7% predominantly due to the exit from the Nationwide and Sainsbury's partnerships. Excluding Nationwide and Sainsbury's, partnership volumes reduced by 2.4% in 2018.

Gross written premium was 24.1% lower than 2017, predominantly due to the reduction in partnerships. Own brands gross written premium rose by 0.7% with increases across all brands. New business volumes were lower during the second half of 2018 as shopping levels slowed following the anniversary of the introduction of the new rules requiring the previous year's premium to be included on renewal documents. Retention in Home own brands continued to be strong.

Home own brands average written premium[3] increased slightly by 0.4% compared with 2017, with a 3.5% price increase offset by a reduced risk mix.

Note:
1. The exit from Sainsbury's is in respect of new business.
2. By original channel.
3. Average incepted written premium excluding insurance premium tax for Home own brands for year ended 31 December 2018.

Providing an action plan within 24 hours for our customers

Fast Response was designed to enable our home insurance customers to get their home back on track, following damage caused by a severe water leak, with minimal disruption to their daily lives.

Our proposition provides for us to be there within 24 hours of the incident to make the important decisions on the repair that will get our customers' homes back to normal. Once a claim has been reported, our suppliers arrange an appointment with customers within 24 hours, including over weekends.

Our technician will leave the customer with clear next steps on when they will be contacted and what action they are recommending. During the first visit claims evidence is also captured on video and reported back to the office to speed up the process, all contributing to a fast response.

24 hour
response, including weekends

Our customers said:

" The company is being supportive at the worst time

" Immediate assistance is a great feature of the policy

The current-year attritional loss ratio, excluding major weather event claims, increased by 5.0 percentage points to 57.0%, reflecting changes in business mix, and was more than offset by lower commissions from partnerships. Claims inflation, excluding the impact of major weather events, remained within the Group's long-term expectation of 3% to 5%. Subsidence claims, including those associated with the dry summer weather in the UK, were not materially above normal annual expectations.

The commission ratio of 9.4% was 8.3 percentage points lower than for 2017, reflecting lower commission and profit share payments to partners resulting from the exit from the Nationwide and Sainsbury's partnerships and changes to other partnership commission arrangements.

Home's combined operating ratio increased by 4.2 percentage points to 93.6% (2017: 89.4%) with higher loss and expense ratios, in part offset by an improved commission ratio. The loss ratio was 11.2 percentage points higher at 61.8% compared to 2017 primarily as a result of the major weather events in Q1 2018. The impact of weather in Q1 was approximately £65 million (2017: £13 million), and no additional major weather events were experienced for the remainder of the year. Normalised for weather, the combined operating ratio was approximately 2.0 percentage points better than last year at 92% (2017: approximately 94%).

Rescue and other personal lines

- Total gross written premium remained broadly stable as growth in Green Flag Rescue and some premium inflation in Travel were offset by lower partnership and packaged account volumes
- The Group's direct Rescue brand, Green Flag, grew in-force policies by 11.5% and gross written premium by 14.3% in the year
- During 2018 the Group successfully renewed two major Travel partnerships with RBS Group and Nationwide for a further five years

	2018	2017
In-force policies (thousands)	7,532	7,739
Of which: own brands	894	802
Gross written premium	£422.8m	£421.1m
Of which: Rescue	£163.4m	£161.3m
Travel	£143.9m	£143.4m
Pet	£72.4m	£74.8m
Other personal lines	£43.1m	£41.6m
Loss ratio	66.8%	65.4%
Commission ratio	4.6%	5.5%
Expense ratio	23.8%	23.4%
Combined operating ratio	95.2%	94.3%
Operating profit	£43.4m	£43.6m

Overview

The Rescue and other personal lines segment consists of Rescue products which are sold through the Green Flag brand and other personal lines insurance, including Travel and Pet, which are sold through own brands and partnership arrangements.

Green Flag continued to position itself as the market disrupter, with the launch of a new advertising campaign in the year. Travel claims inflation remained in line with medium to long-term expectations during 2018. Less volatile currency movements drove lower claims inflation and this was reflected in lower premium inflation than in previous years. Brexit uncertainty remains a risk, however, with the impact on customers and claims with the possible withdrawal of the European Health Insurance Card scheme potentially leading to customers' greater reliance on travel insurance.

Performance

Rescue and other personal lines in-force policies fell by 2.7% to 7.5 million. Gross written premium for Rescue and other personal lines increased by 0.4% compared with 2017. Green Flag continued to grow its higher margin direct business during 2018, increasing in-force policies by 11.5% to over 894,000 as 2018's extreme weather events reminded potential customers of the benefits of having breakdown cover. Gross written premiums grew by 14.3% to £69.6 million which was driven by higher volumes and a shift towards higher levels of cover which attracted higher average premiums.

In-force policies for the Group's linked rescue channel reduced to 1.9 million, driven by the end of the Churchill 'Free Rescue' campaign in July, where Churchill Motor customers received a year's Rescue cover when they purchased their policy. Rescue partnerships in-force policies and gross written premiums, where margins tend to be lower than for direct, reduced, driven by a partnership exit and a reduction in packaged bank account volumes.

Other personal lines in-force policies reduced by 2.6% to 4.0 million primarily due to lower packaged bank account volumes. The rate of reduction of Pet in-force policies slowed considerably in 2018 and insurance packages tailored for mid-to high-net worth Home and Motor customers saw strong growth. Gross written premium remained broadly stable as a slight growth in Travel offset a reduction in Pet.

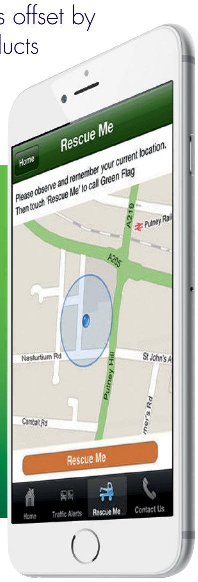
The combined operating ratio for Rescue and other personal lines increased by 0.9 percentage points to 95.2% (2017: 94.3%) primarily due to an increase in the loss ratio partially offset by a lower commission ratio. During the year, Rescue experienced a higher average claims cost due to a mix of recoveries, weather conditions and a restructuring of the Group's third-party recovery network. As a result, Rescue's combined operating ratio increased to 85.0% (2017: 82.8%). Other personal lines combined operating ratio was stable as improved performance in Pet and Travel was offset by weather-related and large claims in Home products for mid-to high-net worth customers.

Common sense to the rescue for our customers

The Rescue Me service on the Green Flag app is making a stressful situation a little less hassle for our customers. Using the app customers can:

- Request a rescue which will pinpoint their location so they don't have to worry about providing directions
- Track their technician so they know when they will be arriving
- Receive updates on the progress of their breakdown

With data driving every customer experience we are implementing technology to deliver the high level of service that customers expect from their breakdown provider. Our challenger status is reaffirmed in our most recent pledge to provide customers with 50% off their RAC or AA renewal quote.



Commercial

- Total gross written premium increased by 1.9% with direct own brands increasing by 7.7%
- Strong performance in Direct Line for Business, with new propositions rolled out on its innovative technology platform targeting small businesses
- NIG premium stable year on year as it focused on delivering its strategy and improving margins

	2018	2017
In-force policies (thousands)	755	708
Of which: own brands	499	468
Gross written premium	£511.0m	£501.5m
Of which: DL4B	£132.0m	£122.6m
NIG and other	£379.0m	£378.9m
Loss ratio	51.8%	49.9%
Commission ratio	18.9%	19.1%
Expense ratio	24.8%	24.4%
Combined operating ratio	95.5%	93.4%
Operating profit	£60.0m	£74.0m

Overview

The Commercial broker market continued to consolidate in 2018. Customers continued to seek cover that was flexibly tailored to their individual needs and demonstrated knowledge about their trade in the direct market. Against this backdrop, Commercial maintained underwriting discipline and grew its policy count.

Direct Line for Business continued to roll out a range of innovative propositions for small and micro businesses, including the launch of its Office, Professionals and Retail insurance products. Direct Line for Business also launched a national marketing campaign to increase awareness of its offering amongst its target market.

In NIG, the focus continued to be on profitability and delivering on its service proposition to be 'Effortless to Trade With'.

Performance

Commercial in-force policies increased by 6.6% compared with 2017 to 755,000. This reflected strong growth in both Direct Line for Business and NIG and other. Gross written premium increased by 1.9% to £511.0 million.

Direct Line for Business grew in-force policies by 6.6% as it grew in its traditionally strong areas of van and landlord, supplemented by growth in the small and micro business products on its new platform. Gross written premium increased by 7.7% to £132.0 million with increases across all product lines.

NIG and other in-force policies grew by 6.7%. Gross written premium remained steady at £379.0 million as the business continued to focus on improving margins and delivering on its strategy.

The current-year attritional loss ratio in Commercial improved by 2.0 percentage points to 66.8% as risk selection over volume remained the priority. Prior-year reserve releases were £6.9 million lower at £79.4 million.

The combined operating ratio for Commercial increased by 2.1 percentage points to 95.5% (2017: 93.4%), primarily due to a 1.9 percentage points increase in the loss ratio as a result of the major weather events in Q1 2018 and the reduction in prior-year reserve releases, partially offset by an improvement in the current-year attritional claims ratio. The impact of weather events in 2018 was approximately £10 million.

Commission and expense ratios remained broadly stable compared to 2017 despite increased pressure on commissions due to broker consolidation.

Flexible insurance that keeps up with our small business customers

In 2016 Direct Line for Business launched a new end-to-end business transformation programme to create a proposition that enables small business owners to buy insurance direct and with confidence. The proposition targets a number of trades, ranging from hairdressers and dog walkers to IT consultants and cake makers, and allows them to create a flexible policy that is unique to their business.

- An intuitive online tool asks small and medium-sized enterprise owners four or five questions about their business that are used to personalise the rest of their journey according to their trade and individual circumstances
- Each cover option gets broken down in the policy, showing individual prices and giving business owners full transparency when buying their policy
- No mid-term amendment admin fees means that customers have the flexibility to make changes to their policy, whether they are increasing their workforce, moving to new premises or working from multiple locations, giving them peace of mind that they have an insurance policy flexible enough to keep up with their world.

Managing our risks

We have a comprehensive risk management framework in place to ensure we have a strong understanding of the risks we run in the course of our business; and appropriate controls are in place with the aim of ensuring we remain within risk appetite.

Managing risk in line with our strategy

Management, with oversight and challenge from the Board, is responsible for developing our strategy. Our strategic planning process aims to ensure we have developed clear objectives and targets, and identified the actions needed to deliver them, including the management of risk. The delivery of a strategic plan will, by its very nature, result in risks and therefore understanding and managing those risks appropriately is a key aspect of the strategic planning process. The Group's risk strategy is aligned with the Group strategy and supports business decision-making through the proactive identification, assessment and management of risks. The Group's risk strategy is consistent with our overall long-term ambition of sustainable growth and at least a 15% RoTE per annum delivered while remaining within our risk appetite.

Our risk governance framework

The Board sets and monitors adherence to the risk strategy, risk appetite and risk framework, and has established a risk management model that separates responsibilities into 'Three Lines of Defence'.

Our First Line of Defence is management who are responsible for owning and managing risks to achieve our business objectives on a day-to-day basis. The Second Line of Defence is the Risk function which is responsible for the design and implementation of the Enterprise Risk Management Strategy and Framework ("**risk management framework**"), and for providing proportionate oversight of, and challenge to, the business's handling of risks, events and management actions. Group Audit is the Third Line of Defence, providing an independent and objective view of the adequacy and effectiveness of the Group's risk management, governance and internal control framework.

The Group's governance structure is set out in more detail in the corporate governance section.

Risk appetite

Our risk appetite statements define the risks we are prepared to accept to achieve our business objectives. The processes for setting risk appetite, particularly the cascade, assessment, mitigation and reporting of risk exposures against risk appetite, are documented in the Group's policies and underlying minimum standards. To monitor whether the business remains within risk appetite, we use key risk indicators, among other information.

We derive the key risk indicators from the risk appetite statements which are used to drive and monitor risk-aware decision-making.

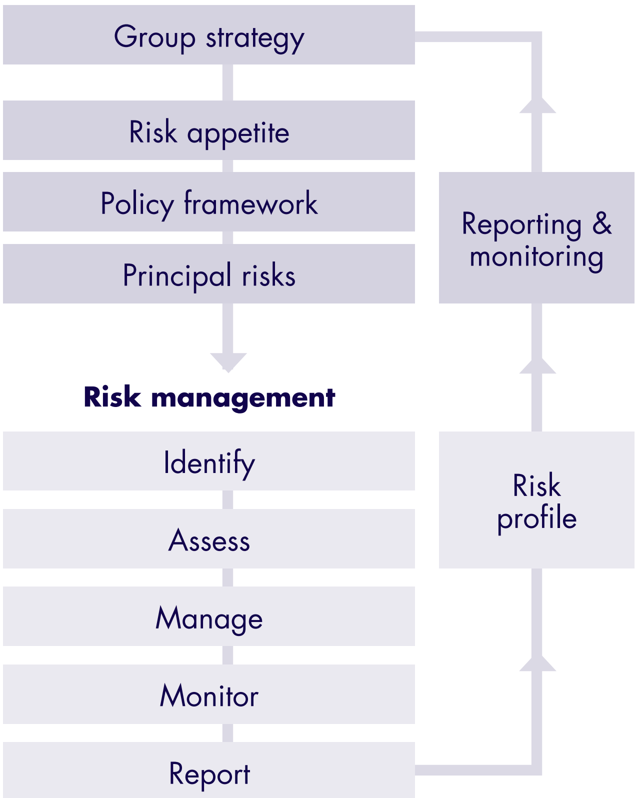
These key risk indicators are qualitative and quantitative, and forward and backward-looking. We review our risk appetite statements and key risk indicators annually.

Risk objective	Risk appetite statement
Overarching risk objective	The Group recognises that its long-term sustainability is dependent on having sufficient economic capital to meet its liabilities as they fall due, thus protecting its reputation and the integrity of its relationship with policyholders and other stakeholders. As part of this, its appetite is for general insurance risk, focusing on personal lines retail and small and medium-sized enterprise insurance in the UK. The Group has appetite for non-insurance risks, as appropriate, to enable and assist it to undertake its primary activity of insurance.
Maintain capital adequacy	The Group seeks to hold capital resources in the range of 140% to 180% of the internal model solvency capital requirement. The Group also seeks to maintain sufficient economic capital consistent with its strategic aim of maintaining a credit rating in the 'A' range.
Stable and efficient access to funding and liquidity	The Group aims to meet planned and unexpected cash outflow requirements, including those requirements that arise following a 1-in-200 years insurance, market or credit risk event.
Maintain stakeholder confidence	The Group has no appetite for material risks resulting in reputational damage, regulatory or legal censure, poor customer outcomes, fines or prosecutions, and other types of non-budgeted operational risk losses associated with Group conduct and activities. The Group will maintain a robust and proportionate internal control environment.

Our Enterprise Risk Management Strategy and Framework

This section sets out, at a high level, our approach to setting risk strategy and the risk management framework for managing risks. It documents the high-level principles and practices to achieve appropriate risk management standards and demonstrates the inter-relationships between components of the risk management framework – see diagram.

The risk management framework enables us to manage the business with the necessary understanding of our risks and controls, while also having the appropriate levels of oversight to ensure risks are managed proactively. The risk management framework is aligned to the Three Lines of Defence model, and provides a comprehensive approach for managing our risks. Our Policy Framework is a central part of the risk management framework, and includes policies and minimum standards which provide the context and risk appetite boundaries within which the business conducts its activities.



Our risk culture

Our risk culture underpins our business and decision-making, and helps us embed a robust approach to managing risk. Our risk culture is demonstrated in the understanding and business-wide use of the risk management systems and processes and through risk-aware decision-making. The Board is committed to promoting a culture of high standards of corporate governance, business integrity, ethics and professionalism in all our activities. An annual assessment of risk behaviours and attitudes is undertaken jointly by the Risk function and Group Audit and considers a range of factors influencing risk culture. This process is overseen by the Board Risk Committee on behalf of the Board.

Principal risks and uncertainties

We carefully assess the principal risks facing us. Principal risks are defined as having a residual risk impact of £40 million or more on a 1-in-200 years basis, taking into account customer, financial and reputational impacts.

	Principal risks	Management and mitigation examples
Insurance risk	The risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting. Key drivers of the outlook for insurance risk across our business plan include reserve, underwriting, distribution, pricing and reinsurance risks. See pages 146 to 148	– We set our reserves using the latest internal and external data and trends – Third-party experts review the majority of our reserves – Underwriting guidelines are set for all transacted business, and pricing refined by analysing comprehensive data – Catastrophe and motor excess of loss reinsurance limits our exposure to events and large losses – We invest in enhanced external data to analyse and mitigate exposures – We estimate technical reserves using various actuarial and statistical techniques. Management's best estimate of total reserves is set at not less than the actuarial best estimate
Market risk	The risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. Key drivers of market risk are the sensitivity of the values of our assets and investments to changes in credit spreads, and our exposure losses as a result of changes in interest rate term structure or volatility. See pages 148 to 151	– We have an investment strategy approved by the Board – We diversify asset classes including by country of risk, and by investing in US dollar assets to broaden the pool of available assets – We set limits on exposure to individual asset classes and the amount of illiquid investments – We carry out an annual matching exercise on our assets and liabilities, which reduces the net impact of interest rate risk as shown in interest rate sensitivities – To limit exposure to credit spread risk, we tightly control individual asset exposures as shown in spread risk sensitivities – We use risk-reduction techniques, such as hedging foreign currency exposures with forward contracts, and hedging exposure to US interest rates with swap contracts
Credit risk	The risk of loss resulting from default in cash inflows and/or changes in market value of issuers of securities, counterparties and any debtors to which the Group is exposed. This includes the risks associated with inadequately diversified portfolios of assets and/or obligations. See pages 151 to 155	– Credit limits are set for each counterparty and we actively monitor credit exposures – We only purchase reinsurance from reinsurers with at least an A– rating. For liabilities with a relatively long period of time to settlement, this rating will be at least A+ – We have well-defined criteria to determine which customers are offered and granted credit

Principal risks		Management and mitigation examples
Operational risk	The risk of loss due to inadequate or failed internal processes or systems, human error or from external events. The principal risks within this category are information security, partnership contractual obligations, change, outsourcing and technology and infrastructure risks. See page 156	– We have appropriate operational processes and systems, including detection systems for fraudulent claims and appropriate processes which seek to enable operational resilience – We are continuing to work to improve performance and stability of our IT systems while focusing on developing future systems capability. With significant change underway, we are continuing to monitor risks associated with our IT systems' stability, and resilience, cyber security, and the internal control environment – Our risk management framework is designed to enable us to capture risk information in a robust and consistent way – We monitor how risks are managed in the performance of outsourced and off-shored activities
Regulatory and conduct risk	The risks arising out of changes to laws, regulatory rules, policy or interpretation, or to supervisory expectations or approach, that have an adverse operational and financial impact as a result of reputational damage, regulatory or legal censure, fines or prosecutions, and any other type of non-budgeted operational risk losses, associated with the Group's conduct and activities.	– We maintain a constructive and open relationship with our regulators – We use specific risk management tools and resources to help manage our exposure to regulatory risk – We have a strong culture of delivering on our commitments to our customers – Our conduct risk management framework is designed to deliver fair outcomes to customers and minimise our risk exposure – We carry out planned risk-based monitoring of customer processes as well as more targeted thematic reviews which consider strategic or regulatory projects
Strategic risk	The risk of direct or indirect impact on the earnings, capital, or value of the business as a result of the strategies not being optimally chosen, implemented or adapted to changing conditions.	– We agree, monitor and manage performance against the Board-approved plan and targets – The Board leads an annual strategy and planning process which considers our performance, competitor positioning and strategic opportunities – We identify and manage emerging risks using established governance processes and forums

Potential effects of Brexit

The UK is scheduled to exit from the EU on 29 March 2019. At the date of this report there is considerable uncertainty as to how and even whether there will be a Brexit, or at least as to when it will take effect and on what terms. Accordingly there is corresponding uncertainty as to the effect of Brexit on the Group.

If Brexit takes place smoothly, for example involving a transition period during which work would take place at the government level to agree a future trading agreement between the UK and the EU, and accordingly without significant disruption to the UK economy and to business generally, then any adverse impact on the Group (if any) would also not be expected to be significant, at least until the end of the transition period and the future trading arrangements between the UK and the EU being clarified. If, however, the UK were to leave the EU in such a way as to involve or lead to significant disruption, as has been conjectured in the event of a 'hard' no deal Brexit at the end of March, then the impact on the Group could correspondingly also be disruptive and potentially material.

Following the EU referendum result in 2016, which saw the UK vote to leave the EU, the Group established a Brexit Working Group comprising representatives from across the Group. It was identified that there was a risk that the UK could enter a prolonged period of reduced growth due to Brexit, potentially reducing insurance sales and the value of our investment portfolio. Whilst our operations are based mainly in the UK, Brexit-related issues which could impact adversely on the Group could include: changes to the value of sterling which impact claims and non-claims supplier costs; inflation; impacts on credit spreads which in turn could impact on the Group's investments and capital; recruitment and retention of people; impacts on the speed of delivery and cost of goods and services required by the business including for fulfilling insurance claims made by customers, for example because of delays at borders caused by increased border regulations and by additional costs caused by increased tariffs and devaluation of sterling; availability of reinsurers authorised to write business in the UK; data transfers; the removal of the European Health Insurance Card ("**EHIC**") leading to greater reliance on travel insurance; travel disruption; increased use of Green Cards (internationally recognised certificates that act as proof of insurance, including in the EU); potential changes to direct and indirect tax; and the regulatory impact on our capital position.

The Group has proactively considered a variety of possible implications of a disruptive 'hard' Brexit, including of a financial and operational nature; for example:

The impact on the Group's investment portfolio and in particular credit spreads relating to its debt securities and therefore Group solvency: A sensitivity analysis relating to its credit spread is provided in note 3.3.2 to the financial statements (on page 151). The Group has also considered Brexit in its Investment Committee, and further information is provided on the work of the Investment Committee on page 87. A disruptive Brexit could impact adversely on the Group's investments and therefore capital and the solvency capital ratio and the appropriateness of paying dividends.

Procurement and supply chain: In particular as part of the Group's ability to deal with claims made under insurance policies, the Group needs to acquire a wide range of goods and services. A significant amount and spread of goods, for example such as car parts, are sourced from within the EU. The Group has been in discussion with principal suppliers who have taken some steps to increase stocks within the UK in the event of a 'hard' Brexit leading to disruption at borders. However, the Group's ability to deal with claims in its normal ordinary course of business manner could be adversely impacted and there could be delays and extra costs.

The Group has a small amount of business in the Republic of Ireland, servicing a small Irish part of a UK partner's wider business. The Group is well advanced in establishing a formal third-country branch in the Republic of Ireland in order to be able to continue with this business post a 'hard' Brexit, and expects the branch to be authorised for business by the Central Bank of Ireland by the current deadline of 29 March 2019, should that become necessary.

The Group has also been focusing on Brexit from a potential crisis management perspective, with the objective of maintaining operational resilience in the event of a disruptive Brexit and with a view to being able to react better to events as they unfold.

Emerging risks

Our definition of emerging risks is new or developing risks which are often difficult to quantify; they are also usually highly uncertain and external to the Group. Emerging risks are identified by management and the latest information is maintained within an Emerging Risk Register. Each emerging risk is owned by a business subject matter expert and members of the Second Line of Defence provide challenge and oversight of activity taking place. We report emerging risks to the Board Risk Committee for review and challenge. Our emerging risks processes aim to:

- identify emerging risks on a timely basis;
- manage emerging risks proactively;
- mitigate the impact of emerging risks which could affect the delivery of the strategic plan; and
- reduce the uncertainty and volatility of our business's results.

We consider our main emerging risks to be:

Climate change

Climate change poses a range of financial risks to the Group. These can be divided into three categories:

- Physical risks include many weather-related risks arising directly from climate change. These include changes in the frequency and severity of events, floods, storms, freeze, subsidence or wildfire. The Group's use of catastrophe reinsurance mitigates against many of the worst potential impacts and the Group regularly reassesses its use of external catastrophe models to ensure they fully capture climate-related risk.

– Transitional risks arise from efforts to mitigate or adapt to climate change. These include the strategic and operational risks from the transition towards electric-powered vehicles. Whilst insuring electric vehicles does not fundamentally change the business model, the business seeks to develop the new processes, skills and technical knowledge required to keep pace with these changes in technology.
– Liability risks arise when parties, who have suffered losses from climate change, seek to recover from those they believe may have been responsible. There is some potential exposure to liability risk through commercial liability insurance. However, Pollution and Professional Indemnity covers, which carry the highest risk, are almost fully reinsured.

There are also potential physical, transition and liability risks arising through the investment portfolio. During 2018 a significant new initiative was approved to strengthen further the Group's investment strategy with regard to environmental, social and governance issues. More information can be found in the Investment Committee's report on page 87.

Technological developments change consumer needs for insurance

New car technologies, such as crash-prevention aids, car sharing and driverless cars, could significantly affect the size and nature of the insurance market and the role of insurers. The Group continues to build strong collaborative relationships with key manufacturers, and has established an 'In-Car Technology' programme to help manage the response to developing car technology.

Furthermore, the Group's strategic pillars of being a great retailer, smart and efficient manufacturer and leading disrupter, as well as our aim of multi-channel success, help position us to take advantage of changes in technology and customer behaviours, through the development of new capabilities, new partnership capabilities, and by enabling us to have the flexibility to adapt/react to these changes.

Fairness and pricing practices

The FCA is conducting a market study into Fair Pricing in Financial Services and the Competition and Markets Authority has announced plans to take forward a 'package of reforms' to address the 'loyalty penalty' for long-standing home insurance customers, but has concluded that it will not be conducting its own market study at this time.

The Group remains up-to-date with developments from the FCA and the Competition and Markets Authority work on pricing practices and will keep the review in focus throughout 2019 as well as seeking to ensure that the Group continues to maintain fair pricing principles.

Viability statement

In accordance with provision C.2.2 of the 2016 UK Corporate Governance Code, the Directors have assessed the prospects of the Group for a period longer than the minimum 12 months required by the going concern statement.

The Strategic report, on pages 1 to 59, sets out the Group's financial performance, business environment, outlook and financial management strategies. It covers how the Group measures its regulatory and economic capital needs, and deploys capital. You can find discussion about the Group's principal risks and risk management in this section. Note 3 to the consolidated financial statements starts on page 146 and sets out financial disclosures relating to the Group's principal risks. This covers insurance, market and credit risk, and the Group's approach to monitoring, managing and mitigating exposures to these risks.

Every year, the Board considers the strategic plan and an Own Risk and Solvency Assessment ("ORSA") for the Group. The plan makes certain assumptions in respect of the competitive markets in which the Group operates, and the delivery and implementation of the new customer systems. Appropriate aspects of the strategic plan are stress-tested to understand and help set capital and other requirements.

When reviewing the strategic plan, the Board considered the Group's prospects over the period that the plan covered and the conclusions of the ORSA, based on the Group's anticipated activities as set out in the strategic plan. This review included reviews of solvency, liquidity, assessment of principal risks, and risk management over a three-year period, with a further two years of indicative planning. The first year following approval of the strategic plan has greater certainty, so it was used to set detailed budgets across the Group. Outcomes for the subsequent years in the plan are less certain. However, the plan provides a robust planning tool for strategic decisions. The Board recognises that, in a strategic plan, uncertainty increases over time and, therefore, future outcomes cannot be guaranteed or accurately predicted.

Based on the results of these reviews, the Board has a reasonable expectation that the Company and the Group can continue in operation, and provide the appropriate degree of protection to those who are, or may become, policyholders or claimants in the period to 31 December 2022.

ESG – our approach

We aim to drive sustainable outcomes for our stakeholders and in order to deliver this we have developed a five pillar strategy which resonates with our collaborative culture and values. Our approach to environmental, social and governance matters is delivered through our five pillars and the table below shows where information can be found in this annual report and accounts.

Pillars	Our customers Making insurance much easier and better value	Our society Playing an active role in issues that affect our society	Our planet Reducing, reusing and recycling to build a sustainable future
Initiatives	Tailored brands p.5 Routes to market p.9 & 19 Renewal pricing principles p.18 & 21 Customer focus p.22, 52 & 81 Propositions p.39, 41, 42 & 43	Autonomous vehicles p.21 Young drivers p.54 & 85 Road safety p.53 & 85 Women in Finance p.58 Supporting charities p.53, 54, 85 & 86	Recycling coffee cups p.55 Environmental Champions p.55 Investment in green bonds p.54 & 87 Travel free weeks p.55
Disclosures	Net promoter score p.25 & 52 Customer complaints p.25 & 52 Non-financial KPIs p.25	Paying tax p.37 & 54 Recycling p.55	Emissions p.20, 55, 85 & 120 Waste p.55 Climate change p.48, 49 & 55
Policies	Connect training p.20 Customer approach p.61 Data protection p.81	Prompt payment code p.54 Ethical investment p.54 & 87	Upgrading our buildings p.20 Diverting 100% of office waste p.55 Commitment to 100% electricity from renewable sources p.55

Our stakeholders

The Board believes that adopting a business model that is sustainable in the long term and based on high ESG standards is important for promoting the success of the Company. In discussing and approving the Group's strategic and financial plan, the Board considers the potential impact on all stakeholders in the business, including employees, customers, suppliers, the communities with which we interact and the environment, as well as the shareholders for whom we aim to continue generating returns on investment. You can find more detail about the stakeholder matters discussed by the Board when considering the strategic plan on page 66.

Our culture as a business flows from the beliefs underpinning the five pillars of our approach to Responsibility, which are set out in this section.

Our people

Investing in our talented people, encouraging everyone to aim higher

- Diversity and inclusion p.58
- Employee Representative Body p.56 & 61
- Employee ideas forum p.57
- Mental health/wellbeing p.59
- Women in Finance Charter p.58
- Values p.60

- Employee surveys p.17 & 56
- Gender pay gap p.58 & 59
- Living wage p.58

- Diversity and inclusion p.73 & 85
- Annual Incentive Plan p.58
- Employee share ownership p.16 & 58
- Development and training p.20 & 59
- Parental leave and flexible working p.57

Our governance

Creating a long-term business that serves all of our stakeholders

- Culture and values p.60 & 61
- Board (leadership and diversity) p.66, 67 & 73
- Risk governance p.44 & 45
- ESG p.85 & 86
- Strategic planning p.68

- Remuneration p.61 & 88
- Board effectiveness p.70
- Auditor fees p.79
- Committee structures p.68 & 69

- UK Corporate Governance Code p.66
- Stakeholder interests p.66
- Whistleblowing p.82
- Modern Slavery Act p.86
- Anti-bribery and corruption policy p.82
- Risk governance p.82
- Code of business conduct p.61

ESG Oversight

Board

The Direct Line Group Board oversees all of the Group's ESG activity. It has delegated particular aspects of this supervision to its Committees.

The **Remuneration Committee** determines remuneration for senior management and reviews workforce remuneration.

The **Corporate Social Responsibility Committee** focuses on the Group's responsibility for the environment, the community and the wellbeing and engagement of its people.

The **Investment Committee** considers the strategy for incorporating ESG factors into the Group's investment management.

The **Board Risk Committee** oversees all aspects of financial, regulatory and operational risk, including the long-term risk to the Group of climate change.

The **Audit Committee** focuses on sustainability in the Group's financial disclosures.

The **Nomination Committee** monitors developments in governance and investor ESG expectations, as well as being responsible for Board succession planning.

More information about the activities of each of the Committees can be found in the Committees' reports on pages 76 to 87.

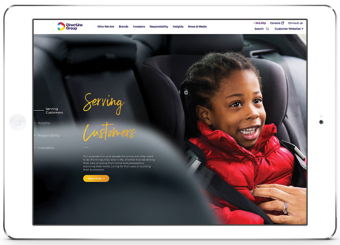
Non-financial information statement

This diagram sets out where stakeholders can find information in our Strategic report that relates to non-financial matters, as required under the new regulations[1] on reporting non-financial information.

Our business model, pages 22 & 23

Principal risks and impact on business activity pages 44 to 49

1. The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016, SI 2016 No 1245.



Further information on our ESG pillars, strategy and full disclosure can be found online at www.directlinegroup.co.uk/en/investors/esg.html

Long-term sustainability for our stakeholders

Under the leadership of our Board, responsibility is at the heart of how we think about our business. Our five pillar ESG strategy ensures that we target delivering long-term sustainability for our customers, our people and our shareholders and that we consider the impact we have on our society and our planet.

Our approach to responsibility is structured around five pillars:

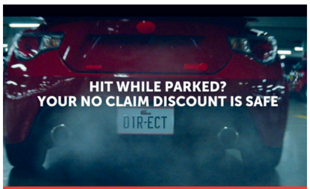
Our customers	Our society	Our planet	Our people	Our governance
Making insurance much easier and better value	Playing an active role in issues that affect our society	Reducing, reusing and recycling to build a sustainable future	Investing in our talented people, encouraging everyone to aim higher	Creating a long-term business that serves all of our stakeholders
See page 52	See pages 53 – 54	See page 55	See pages 56 – 59	See pages 60 – 121

Our customers

Customers are at the heart of everything we do, and as such our work in pursuit of making insurance much easier and better value for our customers is highlighted throughout this report. You can read about our brands, products and channels on the following pages. Our latest customer propositions can be found on pages 39 and pages 41 to 43 and our strategy in action on pages 20 and 21 outlines how we are delivering outcomes for our customers.

We've built a reputation for delivering for our customers by regularly developing new and different ways to make our products easier and better value for our customers. Propositions such as our Churchill Vandalism Promise, Direct Line's Fair Claim Commitment or Fast Response are ways of making insurance easier and we've used training to help our people have far more empathetic and powerful conversations with our customers.

We recognise that our customers are always raising their expectations and one of our values is to "aim higher". The relationship between NPS and customer retention shows there's a direct link between customer experience and our success as a business and that's why this year we launched an initiative designed to help us identify, meet and exceed customer expectations when we make decisions and choices about how we run our business.



See Motor on page 38

See Rescue and other personal lines on page 42

See Home on page 40

See Commercial on page 43

One claim every single minute of every single hour, every day of the year

Our society

Brake and PACTS

We continue to engage with important partners in the road safety debate, including road safety charity Brake, the Parliamentary Advisory Council for Transport Safety ("**PACTS**") and the Department for Transport.

We remain a committed partner to the road safety charity Brake, campaigning throughout the year to make our streets safer.

Working with politicians, our partnership has raised the profile of local campaigns leading to meaningful change in constituencies throughout the UK. Highlights this year have included the introduction of 20 mph zones near schools, reducing the speed limit on major A roads and tackling speeding on rural roads through greater law enforcement.

We celebrated the successes at Brake's annual parliamentary reception with hundreds of Brake supporters, volunteers and parliamentarians.

Sprintathon

422 of our people took part in a Sprintathon this year, where they ran 100m sprints to cover the marathon distance of 26.2 miles. Our aim was to complete a marathon in the shortest possible time and, more importantly, raise money for Stand Up to Cancer.

An astounding £60,000 was raised for Cancer Research UK, who carry out work that accelerates new cancer treatments and tests for UK patients, and patients across the world, to ultimately save more lives.

Our people pulled together to get involved in this great cause and it was an engaging and rewarding group experience where each individual effort combined to fight cancer. This was a fun and collaborative way to really live our value of 'Working Together'. The marathon was completed in under two hours and there's not many people in the world who can say they achieved that!

Steve Maddock, our Chief Operating Officer, and Judith Cummins MP, who was awarded Brake and Direct Line Group's Parliamentarian of the Year Award and who campaigned for tougher sentences for dangerous drivers.

422
of our people took part

£60,000
raised for Cancer Research UK

Shotgun

As Britain's leading personal motor insurer we want, for both our customers and society, to keep Britain's roads safe. This is particularly true for young drivers where inexperience often leads to more accidents.

The facts are stark:

- The part of the brain that helps assess risk is not fully developed until we reach our mid 20s
- 17 to 19 year olds are involved in 9% of all fatal and serious crashes, despite representing just 1.5% of all drivers
- One in four 18 to 24 year olds crash within two years of passing their driving test

That's why we developed our driving app called Shotgun with the aim of cutting the number of young driver deaths to zero in the first 1,000 miles after passing their test, even if they insure their car with someone else.

Shotgun's real-time feedback after every journey has already led to driver improvement on important safety metrics such as speeding, braking and smoothness.

There is clearly demand for Shotgun, which rewards drivers for good driving. With over 27,000 downloads since launch, we've analysed 3.6 million car journeys covering 32.8 million miles, helping young drivers to be safer on our roads.

One Day

We give every colleague the opportunity to do a full day each year out of the office either individually or as a team, to volunteer for a charity or a community group day.

Our One Day initiative is hugely popular, giving everyone the time to support causes they are personally dedicated to.

This year several of our people supported our national charity Mind, by taking part in a Retail Challenge, where teams competed against each other to raise the most money for the Mind shop they worked in.

One of Direct Line Group's teams competing in Mind's Retail Challenge.

Financial responsibility

Responsible investing

As the Group's investment strategy evolves, it is constantly looking for ways to enhance its investment practices with regard to ESG issues.

To date, the Group's investment strategy has reflected the following initiatives:

- Approximately 95% of externally managed assets are run by managers who are currently signatories to the United Nations-supported Principles for Responsible Investment
- Almost 90% of the investments in the infrastructure debt portfolio are in schools, hospitals and other social infrastructure assets
- The commercial property portfolio invests only in assets with an energy efficiency level of D or higher (or with apportioned funds to achieve this level), exceeding the government minimum requirement of an E rating

During 2018 a significant new initiative was approved to strengthen further the Group's ESG credentials:

- In the first half of 2019, the majority of investment grade bond mandates will transition to be managed against ESG weighted indexes
- Investment guideline amendments now instruct the portfolio managers to prefer investment in green bonds where they offer a similar risk-reward profile to other issues

The Investment Committee's section of the Annual Report can be found on page 87.

Tax

As part of our contribution to society we believe that it is important to pay the appropriate amount of tax and manage our tax obligations responsibly. For the first time, this year we are publishing the Group's total tax contribution of £961.7 million, which includes the Group's direct and indirect tax contribution as well as amounts collected on behalf of the UK Exchequer. See the full tax contribution note and tax strategy on page 37.

Suppliers

The Prompt Payment Code sets out standards for payment practices for the benefit of suppliers. The Group is committed to maintaining the highest possible standards of integrity with suppliers and partners and is a long-standing signatory of the Prompt Payment Code. During the financial year, the Group remained committed to prompt payment terms to ensure fair payment practices.

Our diversity and inclusion practices are in line with the Universal Declaration of Human Rights. Our Ethical Code for Suppliers requires that all our suppliers adhere to the core International Labour Organisation standards. We support the aims of the Modern Slavery Act 2015 and are committed to ensuring that modern slavery is not present in our supply chain.

Our planet

Environmental credentials

Our 'Reduce, Reuse, Recycle' strategy guides the Group in meeting its environmental objectives. Simple changes have proven successful:

- Targeting a 30% reduction in energy consumption by 2020 against a 2013 baseline
- Introducing 'travel free weeks' reducing our CO_2 emissions
- Diverting 100% of office waste from landfill
- Maintaining our commitment to source 100% of our electricity from renewable sources

This year we have taken further steps to build a sustainable future.

Recycling coffee cups

The popularity of coffee presents a recycling challenge for a company our size.

That's why we have partnered with a company called Simply Cups, which works with companies to help them separate the plastic film that can make recycling difficult. We have successfully introduced a pilot in our Bromley office where dedicated recycling points are encouraging our people to use them throughout the building. Simply Cups collects our cups and sends them to a specialist processor which enables us to recycle 20,000 cups per month.

Environmental Champions

To further entrench the importance of sustainability across the Group we have appointed 10 'Environmental Champions' in our core sites. Working with the Institute for Environmental Management they have received accredited training, increasing their awareness of how sustainability issues affect the workplace. They are using this knowledge to discuss a range of environmental issues and drive change across the Group.

Emissions

You can find information on Group-wide greenhouse gas ("GHG") emissions in the chart below – and more details of our emissions in the Directors' report on page 120.

In absolute terms, we have reduced our emissions significantly after rationalising and implementing an energy-savings plan across our estate over the last six years, resulting in a 46% reduction in GHG emissions.

We communicate the details of a carbon management programme through the Carbon Disclosure Project and this year achieved a rating of 'B'.

Waste

We remain focused on improving our waste management systems. In 2018, 98% of total waste produced across the Group was recycled or recovered for energy use. This compares with 72% last year.

Climate change

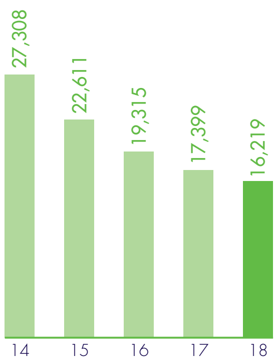
The Group's use of catastrophe reinsurance mitigates against many of the worst potential physical risks from climate change, and the Group regularly reassesses its use of catastrophe models with the objective of ensuring they fully capture climate-related risks.

Efforts to mitigate against climate change are driving a de-carbonisation of the economy, including a transition towards electric vehicles. While this does not fundamentally change the business model, the Group continues to develop the new processes, skills and technical knowledge required to keep pace with changes in vehicle technology.

The Group has reviewed its investment strategy, deciding that a greater weighting should be given towards issuers with stronger ESG credentials (including climate change). More information can be found in the Investment Committee's section of the Annual Report on page 87.

Our Head Office in Bromley is successfully recycling 20,000 coffee cups per month.

Greenhouse gas emissions (tonnes)



Our people

We are nothing without our people. We employ thousands of people throughout the UK who use their skills and expertise to help make insurance much easier and better value for our customers.

We know that to remain a successful business we must reflect the customers we serve on a daily basis. We are proud of our diversity and actively encourage people to celebrate the different personalities that make up the Group. It is central to our values and our identity.

We have an open culture of dialogue between management and staff at all levels. This is underpinned by an Employee Representative Body ("**ERB**") which is made up of colleagues elected by their peers to represent their views at divisional and company-wide level. As of October 2018 our gross staff turnover rate was 16.5%.

It is one of the reasons why we have such an engaged and motivated workforce, with 90% of employees taking part in our employee opinion survey this year.

Yet again we saw positive results, with an increase in our full engagement score from 78% to 81% – 36 percentage points higher than when we first ran the survey in 2014.

The percentage of employees who are proud to work for the Group also increased from 91% in 2017 to 92%, while 87% tell others that the Group is a great place to work (85% in 2017).

92%

of employees are proud to work for the Group

I'm shaping the way we deliver our future recruitment programme. The fantastic technology we can use for video interviews will really move us into the digital era.

CHRISTINE SWIFT
RECRUITMENT TEAM MANAGER, LEEDS

I love how customer focused the business is. It is very open to feedback, encouraging everyone to put forward ideas to improve the customer journey.

DIPIKA BAJWA
CUSTOMER SERVICE ADVISOR, LEEDS

When we receive damaged cars I prepare, paint and polish vehicles to the manufacturer's standard. We have a great working environment here, being part of a team that cares for its customers and employees.

JASON HODGSON
PAINT TECHNICIAN, DLG AUTO SERVICES, WELWYN GARDEN CITY

Best Companies results

We came third in the 'Best Big Companies to Work For' award in the prestigious Sunday Times list 2019. This has come from a collective belief that having a great team of highly engaged people pulling in the same direction will deliver better results for customers, and in turn, great results for shareholders. For more information see www.b.co.uk/the-lists/big-companies.

My life

We understand that work doesn't always come first. We're all human beings with our own families, people we care for, other responsibilities and dreams to follow. We launched a new set of policies, designed to be simple and flexible, to help our people focus on what matters to them.

- Employees with at least one year's service receive full pay during the first 20 weeks of maternity and adoption leave
- Shared parental leave and pay mirrors our maternity and adoption benefits; our employees can ask to split their leave into shorter periods with periods of work in between, to help settle back in as easily as possible
- Up to 12 weeks' full pay as part of a phased return to work following a period of maternity/adoption/shared parental leave for all employees
- Two weeks' paid paternity leave for all employees
- Up to four weeks' unpaid parental leave each year is also available to all parents, carers and grandparents
- A period of paid compassionate leave can be agreed for anyone
- Paid time off and/or flexible working arrangements can be agreed during IVF investigations and treatment
- Up to 12 months unpaid lifestyle break for anyone wishing to pursue something that really matters to them

We know that successful businesses are the ones that offer greater flexibility and take meaningful steps to help people achieve this. We are proud of being one of the first 10 companies to back a campaign calling for large firms to publish policies on their external websites.

Idea Lab

The Group runs Idea Lab, rewarding employees who generate solutions to improve our customers' experience and make the business more efficient. This has empowered people to think differently and share their creativity.

Some of the highlights include:

- Giving our drivers tool kits when returning vehicles to customers in case any further minor damage arises on the delivery which can be instantly fixed
- Improving efficiency with extra vehicle checks for our Green Flag business
- Using dedicated social media pages to alert customers to fraud trends

#thinkdifferently idea lab

This year we celebrated three years of success with over 5,900 ideas.

£3.25 million
Saved for the business

£137,000
Awarded to our people

£27,300
Donated to charity

Diversity and inclusion

Building a diverse and inclusive culture takes multiple initiatives to work together. We remain focused on bringing in new methods to improve our performance, ensuring that all employees take ownership in communicating the importance of inclusive behaviour.

To challenge ourselves, we took the step this year to sign an industry-wide pledge that sets out expected minimum standards of inclusive behaviour. It commits us to speak up and call out inappropriate or discriminatory behaviour, even when it is uncomfortable to do so.

Diversity

The Group is proud of its Diversity Network Alliance ("**DNA**"), the employee network which champions diversity and inclusion in our business.

We are building inclusive leadership programmes for all managers to assist them in managing their teams. Senior leadership teams are also setting specific diversity commitments aligned to their function's needs, including, but not limited to, recruitment and performance decisions.

This year our recruitment team has received training on removing gender-biased language when advertising for roles, including how to use tools which identify gender specific wording.

Pay

In April the Group reviewed its pay structure and introduced a new company-wide minimum base salary of £18,000 for full-time colleagues, 6% higher than the Living Wage and 18% higher than the National Minimum Wage.

As of April 2018, our median gender pay gap was 15.4% compared to the financial services industry average of 22%.

Annual Incentive Plan

The Group's AIP ensures that all our people are judged on the basis of delivering against our Customer Experience and People agendas. We know that a good customer experience means that people are more likely to recommend us to others. This is why the Group's Customer Experience agenda is focused on making it easy for customers when they take out cover, need to make a claim or require complaints to be resolved swiftly. We are only able to deliver this due to our people, which is why we place a sharp focus on diversity and inclusion and regularly engage with our people throughout the year. The AIP therefore ensures a strong link between pay and the Group's performance on these specific metrics.

Employee share incentive scheme

All colleagues are able to benefit from an attractive Buy As You Earn scheme. Our people are rewarded with a top up share for every two they purchase, incentivising people to benefit from the Group's success.

Colleagues have also benefited from free share awards. In March 2018 colleagues received a £500 free share award to celebrate the Group's anniversary of its launch on the London Stock Exchange; this is in addition to three separate share awards made in previous years. These schemes are equivalent to an Employee Stock Purchase Plan and Employee Stock Ownership Plan in the US.

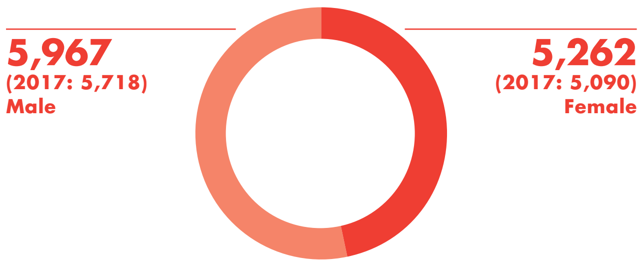
Women in Finance Charter

The Group made significant progress against the Women in Finance Charter commitment of 30% females in senior leadership positions by 2019, and in 2018 we achieved 28%. This improvement has come from a combination of external hires (utilising methods such as gender balanced shortlists), and internal promotions, which will continue by utilising the Group's new cross functional talent mobility forum.

Hampton Alexander Review

The Hampton Alexander Review set targets for FTSE 350 companies to have at least 33% women on their Board and in leadership positions by 2020. The Group is ranked 13th in the FTSE 100 for female Board representation, with 42% of the Board being female. This exceeds the target ahead of time. Within the FTSE 350 Non-Life Insurance sector, we are ranked 1st for female Board representation and 4th for combined Executive Committee and direct reports to the Board.

Gender diversity of all employees



Gender diversity of senior managers

Mental health and wellbeing

Stress, depression and mental health issues are unfortunately increasingly common in the UK. Mental health is central to the Group's Wellbeing Strategy. We give our people immediate access to free and confidential support, with professional, independent and impartial information and counselling. Staff can also talk to our external provider about any issue including stress, work issues, finances, family or personal crises or anything else that is on their mind.

There are a number of steps we have put in place to help us all feel comfortable discussing mental health and raise awareness:

- Our Mental Health First Aider's programme, training over 135 mental health first aiders, meaning we now have at least one on every floor, in every site. This has been supported by training our people managers on mental health and resilience through our 'Engage' programme
- Formed a partnership with the charity Mind in England and their partner charity the Scottish Association for Mental Health with the ambition of raising £100,000, which has the potential to fund 13,000 people in a time of need via Mind's national helpline
- Became a gold partner of This Can Happen, a charity focused specifically on tackling mental health issues in the workplace
- Backed the 'Where's Your Head At?' campaign calling for mental health provision in the workplace to be put on an equal footing with physical first aid
- Our #ThisIsMe campaign has encouraged open and honest discussion about challenges some of our people face daily
- Ran successful lunchtime sessions, exercise classes, holistic treatments and mindfulness sessions during Mental Health Awareness Week
- Ran our first Mental Health First Aider's conference allowing 650 colleagues to come together and collaborate with renowned mental health campaigners

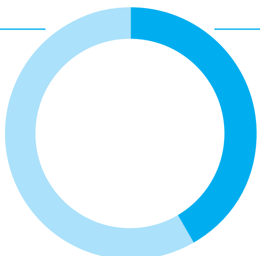
Find out more at https://www.directlinegroup.co.uk/en/responsibility/people/mental-health-and-wellbeing.html

Graduate and apprenticeship programmes

Our graduate programme continues to develop the next generation of leaders. We currently have over 100 graduates placed across the business, gaining first hand experience in areas such as Underwriting, Risk, Claims and customer facing roles. Regular rotation gives them deep insight into the Group's overall business strategy and changing consumer needs.

We also have 285 apprentices gaining technical expertise across various functions including Pricing, Auto Services and Human Resources. Their development is supported by the opportunity to study for vocational qualifications, allowing our apprentices to become established in the business.

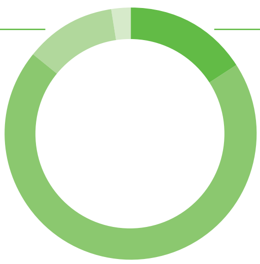
Gender diversity of Board of Directors



7
(2017: 7)
Male

5
(2017: 4)
Female

Age range of employees



264
(2017: 244)
61 & over

1,787
(2017: 1,674)
25 & under

1,323
(2017: 1,244)
51 – 60

7,855
(2017: 7,646)
26 – 50

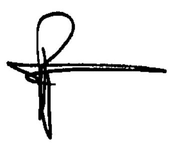
Statement of the Directors in respect of the Strategic report

The Board reviewed and approved the Strategic report on pages 1 to 59 on 4 March 2019.

By order of the Board

PAUL GEDDES
CHIEF EXECUTIVE OFFICER
4 March 2019

PENNY JAMES
CHIEF FINANCIAL OFFICER
4 March 2019



Our Governance

> Strong and robust corporate governance is integral to the creation of long-term value for our shareholders and stakeholders.

Our values

Do the right thing

For our people, our customers, our shareholders and our wider stakeholders; make decisions based on what is right, not what is easy; demonstrate personal and professional integrity; do what's right for the long-term sustainability of our business.

Aim higher

Strive to be the best in every area of the business; be ambitious, courageous and innovative; relentlessly challenge and improve; seek and embrace change; learn from our mistakes; persevere, always deliver our promises and don't settle for second best.

Work together

Collaborate across all levels and functions; leverage the skills, knowledge and experience, irrespective of hierarchy, to deliver the best possible results; develop relationships based on trusting each other, partnerships and win-wins; recognise and celebrate success.

Take ownership

Treat it like it's OUR business; take the initiative, if you can see a better way, go and make a difference; take decisions, be accountable for your actions in whatever role you perform; take responsibility for your personal development and performance.

Say it like it is

Be real, authentic and true to yourself; have open and honest conversations with all audiences in an adult-to-adult manner; listen, seek to understand and respect diversity of views; be open, call out issues we see; share information and keep things as simple as possible.

Bring all of yourself to work

Be the best you can be, the real and whole you; celebrate our diversity of skills, experiences and personalities; be a role model to others, demonstrate a 'can do' spirit, have fun and make this a great place to be; be excited about our Company and our future; believe in yourself, feel confident and empowered.

Dear shareholders and other stakeholders,

On behalf of the Board, I am pleased to present the Corporate Governance report for the year ended 31 December 2018.

Our commitment to good corporate governance

Your Board is committed to putting strong and robust corporate governance at the heart of everything we do. This report explains how your Board has dealt with ensuring that we have effective corporate governance in place to help support the creation of long-term value for our shareholders and stakeholders.

UK Corporate Governance Code 2018

The Board welcomes the new UK Corporate Governance Code and the Guidance on Board Effectiveness which were published by the Financial Reporting Council ("**FRC**") in July 2018 and apply to our 2019 financial year. We seek to ensure that our governance framework remains aligned with best practice and we will report against the new Code in next year's Annual Report.

The Board has arrangements in place to comply with the new Code. For example, in 2018, the Board gave detailed consideration to its workforce engagement mechanisms and agreed that attendance at the Group's national Employee Representative Body ("**ERB**") meetings by NEDs on a rotational basis would enable them to participate effectively in the workforce dialogue and would enable ERB members to benefit from exchanges of views with a variety of NEDs in person.

Succession planning and Board changes

Following the announcement on 1 August 2018, that Paul Geddes will step down as CEO in the summer of 2019, the Board launched a search for his successor.

The Nomination Committee conducted a thorough interview and assessment programme, which is described in more detail on page 83, culminating in its recommendation to the Board that Penny James be appointed as the Group's new CEO. The Board agreed to appoint Penny as CEO with effect from the conclusion of the AGM on 9 May 2019, at which point Paul Geddes will step down from the Board.

After serving as a NED for more than six years, Clare Thompson has also decided to step down from the Board at the conclusion of the 2019 AGM.

The Nomination Committee led the recruitment of Gregor Stewart and Mark Gregory, who joined the Board as NEDs on 1 March 2018, and Fiona McBain, who was appointed as a NED with effect from 1 September 2018. The selection processes were informed by the Nomination Committee's annual review of the Board's balance of skills, experience and expertise.

The Nomination Committee reviews succession plans both for the Board and at executive level each year. The Board recognises the benefit of recruiting leaders who live the Group's culture and values and represent a diversity of gender, ethnicity, cognitive strengths and socio-economic, educational and professional backgrounds. The Board has female representation of 42% and the Board remains committed to the principle that diversity is a key enabler of its effectiveness.

Further information on our diversity policy, our approach to succession planning and Board appointments can be found on pages 83 and 84.

Executive remuneration

The Group's remuneration policy was approved at the 2017 AGM with 98.29% of votes cast and is expected to remain in place for three years. The resolution approving the Directors' remuneration report at the 2018 AGM was passed with 76.58% of votes cast. Whilst the majority of our major institutional shareholders voted in favour of the resolution, we understand some of our shareholders objected to the CFO's base salary compared to that of her predecessor. I have engaged with a number of our shareholders during the year to discuss executive remuneration (in addition to Board succession planning, diversity, data security, climate change and strategic continuity) and to reassure them that good governance is a matter of the highest priority for the Board. Further details on the work of the Remuneration Committee can be found in the Directors' remuneration report on pages 88 to 91.

Effectiveness and evaluation

As Chairman, my principal objective is to guide and develop an effective Board for the benefit of our shareholders, whilst having regard to the interests of our other stakeholders. This year, the Board and its Committees again carried out their effectiveness review in-house with the assistance of the Company Secretary. Suggestions for further improving effectiveness were raised during the review process and taken into consideration by the Board. Further details can be found on page 71.

Culture and values

The Board recognises the importance of its role in setting the tone of the Group's culture and embedding it throughout the Group. The Board aims to create an open and collaborative culture that encourages the Group to make decisions that are best for our shareholders, whilst having regard to the interests of our other stakeholders. I believe that the values and the Code of Business Conduct set by the Board are central to the Group's culture and contribute to the Group's objectives of long-term success and sustainable shareholder value.

Communication with our shareholders and other stakeholders is extremely important to us. By maintaining dialogue with you, we aim to ensure that your views are considered and our objectives are understood. I would like to thank you for your support and look forward to discussing the Group's progress with you at our forthcoming AGM on 9 May 2019.

Yours sincerely,

M N Biggs

MICHAEL N BIGGS
CHAIRMAN

Our Code of Business Conduct

Your Board maintains strong relationships and regular interaction with our shareholders and other stakeholders. Their continued support for our strategic aims is important. Visit www.directlinegroup.co.uk for more information.

MIKE BIGGS
CHAIRMAN OF THE BOARD

N R

Appointed
April 2012

Biography
Mike is Chairman of the Nomination Committee. He has over 40 years' experience of the UK and international financial services sectors.

Mike was previously Chairman of Resolution, then a FTSE 100 UK life assurance business, and has acted as Chief Executive Officer and Group Finance Director of Resolution plc. He was previously Group Finance Director of Aviva plc. He is an Associate of the Institute of Chartered Accountants in England and Wales.

Current external appointments
Mike is Chairman of Close Brothers Group plc.

PAUL GEDDES
CHIEF EXECUTIVE OFFICER

C

Appointed
August 2009

Biography
Paul is the CEO and will be succeeded by Penny James with effect from the conclusion of the Annual General Meeting on 9 May 2019. He has served as CEO for close to 10 years and led the Group's transformation, its separation from RBS Group, its initial public offering and its entry into the FTSE 100.

After joining RBS Group in 2004 as Managing Director responsible for products and marketing, Paul became the CEO of RBS Group's mainland UK retail banking business. Before joining RBS Group, he held various senior multi-channel retailing roles in the Great Universal Stores and Kingfisher groups. Paul started his career in marketing, with UK and European roles at Procter & Gamble.

Current external appointments
Paul is a member of the ABI Board and a NED of Channel Four Television Corporation.

DANUTA GRAY
INDEPENDENT NED

N R

Appointed
February 2017

Biography
Danuta is Chair of the Remuneration Committee. She has extensive experience and knowledge of the telecommunications and financial services sectors. Danuta was Chairman of Telefónica O2 in Ireland until December 2012, having previously been its Chief Executive from 2001 to 2010. Prior to Telefónica O2, Danuta held various senior positions within BT Group from 1984 to 2001.

Current external appointments
Danuta is Chair Designate and a NED of St. Modwen Properties plc. She is also Senior Independent Director ("SID") of Aldermore Group plc and a Non-Executive Member of the Defence Board of the UK Ministry of Defence.

MARK GREGORY
INDEPENDENT NED

A I

Appointed
March 2018

Biography
Mark is Chair of the Investment Committee. He has extensive experience and knowledge of the financial services sector, particularly in life and general insurance. Additionally, he has detailed understanding of the retail sector and customer service.

Mark was Group CFO and Executive Director at Legal & General until August 2017. During his 18-year career at Legal & General, he held a variety of senior roles including CEO of the Savings business, Managing Director of the With-Profits business, and Resources & International Director. Before joining Legal & General, Mark held senior financial and business development roles at ASDA and Kingfisher. Mark is an Associate of the Institute of Chartered Accountants in England and Wales.

Current external appointments
Mark is the Chief Executive Officer of Merian Global Investors Limited.

Key for Committee membership
A Audit Committee
R Board Risk Committee
C CSR Committee
I Investment Committee
N Nomination Committee
R Remuneration Committee

JANE HANSON
INDEPENDENT NED

A R C I

Appointed
December 2011

Biography
Jane is Chair of the Board Risk Committee. She has extensive experience of risk management, corporate governance and internal control. She also has wide experience of developing and monitoring customer and conduct risk frameworks and overseeing IT and transformation programmes.

Jane spent her early career with KPMG, working in the financial sector, becoming responsible for delivering corporate governance, internal audit and risk-management services in the north of England. She has also held a number of executive roles, including Director of Audit, and Risk and Governance Director at Aviva plc. She is a Fellow of the Institute of Chartered Accountants in England and Wales.

Current external appointments
Jane is Chair of Reclaim Fund Ltd and an Independent Member of the Fairness Committee at ReAssure Ltd. She is the Honorary Treasurer and a Trustee of the Disasters Emergency Committee and has her own financial sector consulting business. Jane is also a magistrate.

SEBASTIAN JAMES
INDEPENDENT NED

C R

Appointed
August 2014

Biography
Sebastian is Chair of the Corporate Social Responsibility Committee. He has extensive experience in retail and consumer practice at large groups and has a detailed understanding of the UK consumer markets, products and brands. Sebastian was Group Chief Executive of Dixons Carphone plc from August 2014 to April 2018. Before that, he was CEO of Synergy Insurance Services Limited and subsequently gained wide retail experience as Strategy Director responsible for developing and implementing the turnaround strategy at Mothercare.

Current external appointments
Sebastian is Senior Vice President of Walgreens Boots Alliance and President and Managing Director of Boots. He is also a trustee of the charity Save the Children.

MIKE HOLLIDAY-WILLIAMS
MANAGING DIRECTOR, PERSONAL LINES

Appointed
February 2017

Biography
Mike is Managing Director, Personal Lines. He joined Direct Line in 2014 and has over 10 years' insurance industry experience. Under his leadership, the Personal Lines division has delivered strong growth, improved profitability and strengthened its competitive position.

Mike was previously CEO of RSA Group's Scandinavian businesses, Codan A/S and Trygg-Hansa, and before that UK Managing Director of Personal Lines at RSA, responsible for the MORETH>N, Partnerships and Broker businesses. Before joining RSA, Mike had many general management, marketing and customer growth roles across several industries including the energy, telecoms and retail sectors.

Current external appointments
Mike is a member of the ABI General Insurance Council.

PENNY JAMES
CHIEF FINANCIAL OFFICER AND CHIEF EXECUTIVE OFFICER-DESIGNATE

I

Appointed
November 2017

Biography
Penny is the CFO and CEO-designate. She will succeed Paul Geddes as CEO from the conclusion of the AGM on 9 May 2019. She has extensive financial services experience, having been Group Chief Risk Officer and Executive Director at Prudential plc, where she was responsible for leading risk oversight globally.

Before this Penny was Director of Group Finance at Prudential. She had previously been Group CFO at Omega Insurance Holdings Limited and CFO, UK General Insurance, at Zurich Financial Services. Penny was a NED of Admiral Group plc from January 2015 to September 2017. Penny is an Associate of the Institute of Chartered Accountants in England and Wales.

Current external appointments
None.

FIONA McBAIN
INDEPENDENT NED

Appointed
September 2018

Biography
Fiona has over 30 years' experience in retail financial services, in the industry and as an auditor, in the UK and the USA. She served as CEO of Scottish Friendly Group for 11 years, before which she was Scottish Friendly Group's Finance Director.

Fiona is also an Associate Member of the Institute of Chartered Accountants in England & Wales, qualifying as an accountant early on in her career at Arthur Young (currently known as EY).

Current external appointments
Fiona is Chairman of Scottish Mortgage Investment Trust plc and Non-Executive Director of Dixons Carphone plc.

GREGOR STEWART
INDEPENDENT NED

A R

Appointed
March 2018

Biography
Gregor is Chair of the Audit Committee. He has wide-ranging experience of financial services, including significant finance, audit, risk management and distribution experience gained in the insurance and investment management sectors.

Gregor worked with EY for 23 years, including 10 years as a partner in the financial services practice. Following this, he was Finance Director for the Insurance division of Lloyds Banking Group plc, which included Scottish Widows, from 2009 to 2012. Gregor is a member of the Institute of Chartered Accountants of Scotland.

Current external appointments
Gregor is Deputy Chairman of Alliance Trust PLC, Chairman of Intrinsic Financial Services Limited and is a NED of FNZ Group. He is also Honorary Treasurer of the charity International Alert.

CLARE THOMPSON
INDEPENDENT NED

A R

Appointed
September 2012

Biography
Clare has extensive financial and audit experience in financial services. She was a partner at PwC from 1988 to 2011, during which time she held several senior positions, particularly in the insurance sector. Her roles included People Partner for Assurance, in which she oversaw talent management, career development and the design of remuneration structures for PwC UK. Clare is a Fellow of the Institute of Chartered Accountants in England and Wales.

Current external appointments
Clare is Senior Independent Director of the British United Provident Association ("BUPA").

DR RICHARD WARD
INDEPENDENT NED AND SID

R N

Appointed
January 2016

Biography
Richard is the SID. He was Non-Executive Chairman of Brit Syndicates Limited and Executive Chairman of Cunningham Lindsey from 2014 to 2018. Prior to this, he was Chief Executive of Lloyd's of London from 2006 to 2013. He was also a NED of Partnership Assurance Group plc, now part of Just Group plc, between 2013 and 2016 and was Chairman of the Remuneration Committee from 2014 to 2016. Richard previously worked for over 10 years at the London-based International Petroleum Exchange, the second largest energy trading exchange, re-branded ICE Futures, as both CEO and Vice-Chairman. He has extensive insurance industry experience and insight into prudential regulation.

Prior to the International Petroleum Exchange, Richard held a range of senior positions at British Petroleum and was a research scientist for the Science and Engineering Research Council.

Current external appointments
Richard is Executive Chairman of the Specialty division at the Ardonagh Group. Richard serves as a member of the PRA Practitioner Panel, Bank of England.

Key for Committee membership
- A Audit Committee
- R Board Risk Committee
- C CSR Committee
- I Investment Committee
- N Nomination Committee
- R Remuneration Committee

EXECUTIVE COMMITTEE

Paul Geddes chairs the Executive Committee. In addition to Paul Geddes, Mike Holliday-Williams and Penny James, the Committee comprises the following:

JONATHAN GREENWOOD
MANAGING DIRECTOR, COMMERCIAL

Joined
2000

Experience and qualifications
Jonathan has over 30 years' experience of the insurance industry. He is responsible for delivering the Commercial strategy, developing customer propositions, enhancing the Commercial brands and delivering efficiencies within the Commercial businesses.

Jonathan was previously Managing Director of the Group's household and life businesses. He joined the Group as Product and Pricing Director for UK Partnerships. Before joining the Group, Jonathan held roles at HBOS, MBNA and Pinnacle.

STEVE MADDOCK
CHIEF OPERATING OFFICER

Joined
2010

Experience and qualifications
Steve has nearly 30 years' experience of the insurance industry. He is responsible for leading the Group's Claims, Information Technology, Information Security, Procurement and Business Services functions.

Steve's previous roles include Director of Strategic and Technical Claims at RSA, Director of Claims and Customer Service at Capita, and Director of Operations at AMP. Steve is also Chairman of the Motor Insurers' Bureau.

SIMON LINARES
GROUP HUMAN RESOURCES DIRECTOR

C

Joined
2014

Experience and qualifications
Simon is responsible for leading the Group's HR function, Internal & External Communications and Public Affairs. He is also responsible for delivering the Group's People and Corporate Social Responsibility ("CSR") strategies. Simon is a Fellow of the Chartered Institute of Personnel and Development.

Simon has spent the majority of his career as a leader in customer-centric businesses. Before moving into HR, Simon held several commercial business roles in the fast-moving consumer goods and financial services sectors. Simon is also a trustee of the KidsOut UK charity.

HUMPHREY TOMLINSON
GENERAL COUNSEL

Joined
2011

Experience and qualifications
Humphrey has over 25 years' experience as a solicitor. He is responsible for the Group Legal function and oversees a range of areas of legal advice and services.

Humphrey's experience includes advising on corporate and commercial matters, steering corporate transactions in the UK and internationally, managing legal risk and dealing with corporate governance issues. Before joining the Group, Humphrey was Group Legal Director at RSA and prior to that he was a corporate lawyer with the City law firm, Ashurst Morris Crisp.

JOSÉ VAZQUEZ
CHIEF RISK OFFICER

Joined
2012

Experience and qualifications
José has over 25 years' experience of the insurance industry. He is responsible for the Group's Risk Management and Compliance function and is a Fellow of the Institute of Actuaries.

José was previously Global Chief Risk Officer and Group Chief Actuary at HSBC Insurance. Before joining HSBC, José worked for Zurich Insurance, first in its London Market Operations, then as Chief Actuary International Business Division (Asia, Latin America and Africa) and lastly as Chief Actuary in the UK.

Corporate Governance report

This report explains the Board's role and activities, and how corporate governance operates throughout the Group.

The UK Corporate Governance Code

The UK Corporate Governance Code 2016 (the "**Code**") applied to the financial year ended 31 December 2018. Direct Line Insurance Group plc (the "**Company**") complied with all of the principles and, except as explained below, all provisions of the Code throughout the financial year up to the date of this report. The Company has applied the UK Corporate Governance Code 2018 since 1 January 2019, and will report against this new Code next year.

The only exception is the recommendation contained in Provision E.1.1 of the Code that the SID should attend sufficient meetings with the major shareholders to listen to their views. Throughout 2018, the Board received regular updates from the Company's corporate brokers on the views of its institutional shareholders and, in addition, the Investor Relations team provided regular updates to the Board. The Chairman, CEO and CFO met with key shareholders following announcements of results and reported shareholders' views back to the Board. On this basis the Board is satisfied that it understands the views of shareholders and major shareholders have been invited to meet with the SID should they wish to do so.

It is open to all shareholders to raise any issues they wish with the Chairman, the SID and the Chair of the Remuneration Committee. The Board has therefore concluded that it has complied with the main and supporting principles under section E.1 of the Code regarding dialogue with shareholders.

Further details of how the Company applied the Code's principles and complied with its provisions can be found on the following pages of this report and the Directors' remuneration report:

For more information about the Code, visit the FRC's website at www.frc.org.uk.

Leadership

The Board

The Board understands the views of the Company's shareholders and has regard to a range of other key stakeholders and their interests and other relevant matters in Board discussions and decision-making. The example below demonstrates how the Board recognises that stakeholders' interests are integral to the promotion of the Company's long-term success.

The Board's specific duties are set out in the Schedule of Matters Reserved for the Board, which contains items reserved for the Board to consider and approve, relating to strategy and management, material contracts, financial reporting

Stakeholder interests: the strategic plan

In discussing and approving its strategic and financial plan, the Board carefully considers the potential impact on all of the Group's stakeholders, and other relevant matters, whilst seeking to ensure that the plan promotes the success of the Company for the benefit of its members as a whole. Specific matters discussed by the Board include:

- investments in capability to be made during the plan period to make insurance easier and better value for our customers, supporting the longer-term success of the Group and enabling it to respond to long-term trends in the markets in which it operates;
- engaging with our people to improve our diversity, inclusion, wellbeing and development, providing them with a more productive work environment and the support they need through our flexible working and wellbeing strategies;
- the Group's Code of Business Conduct which supports the Board's commitment to the highest possible standards of integrity in business relationships with our suppliers and partners;
- the Group's ESG philosophy that long-term sustainability is good for all our stakeholders, as part of which our Responsibility strategy supports positive relations with our communities, an appropriate approach to the environment, our partnership with Brake on road safety and our emphasis on mental health; and
- the importance of maintaining the strong and positive reputation of our brands and the significant investment being made to improve customer journeys, through which the Group demonstrates its high standards of business conduct.

Our Chairman, Mike Biggs, and NED, Danuta Gray.

and controls, internal controls and risk management, Board membership and succession planning, corporate governance, structure and capital, and delegation of authority.

In addition to the Schedule of Matters Reserved to the Board, each Board Committee has written terms of reference defining its role and responsibilities. Further details regarding the role and activities of the Board and Board Committees can be found on pages 68 and 76 to 87.

Board composition

As at the date of this report, the Board comprised the Chairman, who was independent when appointed to the Board; three Executive Directors; and eight independent NEDs, including the SID. The current Directors served throughout all of 2018, except for Mark Gregory and Gregor Stewart who were appointed on 1 March 2018 and Fiona McBain who was appointed on 1 September 2018; Andrew Palmer and John Reizenstein also served during the year, retiring from the Board at the conclusion of the AGM on 10 May 2018.

Biographical details of the Directors of the Company as at the date of this report are set out on pages 62 to 64.

Meetings

The Board and Board Committees held a number of scheduled meetings in 2018 at which senior executives, external advisers and independent advisers were invited to attend and present on business developments and governance matters. The Company Secretary attended all Board meetings and he, or his nominated deputy, attended all Board Committee meetings. The table below sets out attendance at the scheduled meetings in 2018[1]. Additional Board and Committee meetings were convened during the year to discuss ad hoc business development, governance and regulatory matters.

Meetings attendance

	Board	Audit Committee	Board Risk Committee	CSR Committee	Investment Committee	Nomination Committee	Remuneration Committee
Chairman							
Mike Biggs	9 of 9	–	–	–	–	3 of 3	4 of 4
Senior Independent Director							
Richard Ward	9 of 9	–	5 of 5	–	–	3 of 3	–
Non-Executive Directors							
Danuta Gray	9 of 9	–	–	–	–	3 of 3	4 of 4
Mark Gregory	7 of 7	3 of 3	–	–	2 of 2	–	–
Jane Hanson	9 of 9	5 of 5	5 of 5	3 of 3	4 of 4	–	–
Sebastian James	9 of 9	–	–	3 of 3	–	–	4 of 4
Fiona McBain	3 of 3	–	–	–	–	–	–
Andrew Palmer[2]	4 of 4	2 of 2	2 of 2	–	2 of 2	2 of 2	1 of 2
Gregor Stewart[2]	6 of 7	3 of 3	3 of 3	–	–	–	–
Clare Thompson	9 of 9	5 of 5	–	–	–	–	4 of 4
Executive Directors							
Paul Geddes	9 of 9	–	–	3 of 3	–	–	–
Penny James	9 of 9	–	–	–	2 of 2	–	–
Mike Holliday-Williams	9 of 9	–	–	–	–	–	–
John Reizenstein	4 of 4	–	–	–	2 of 2	–	–
Executive Committee Member							
Simon Linares	–	–	–	3 of 3	–	–	–

Notes:
1. Attendance is expressed as the number of scheduled meetings attended out of the number of such meetings possible or applicable for the Director to attend.
2. Due to other prior commitments, Andrew Palmer was unable to attend the February 2018 Remuneration Committee meeting and Gregor Stewart was unable to attend the April 2018 Board meeting. Papers were circulated to all Directors before the meetings and those unable to attend could raise issues and give comments to the Chairman in advance of the meetings.

Structure of the Board, Board Committees and executive management

The diagrams on pages 68 and 69 summarise the role of the Board, its Committees and the responsibilities of the Chairman, the SID, the NEDs, the CEO and the Executive Committee. The Board and Board Committees have unrestricted access to management and external advisers to help discharge their responsibilities. The Board and Board Committees are satisfied that, in 2018, sufficient, reliable and timely information was received to perform their responsibilities effectively. Each Committee plays a vital role in helping the Board to operate efficiently and consider matters appropriately.

Board

Leadership

The Board has clear divisions of responsibility and seeks the long-term success of the Group.

Shareholder benefit

The Board organises and directs the Group's affairs in a way that it believes will help the Group succeed for the benefit of its members as a whole, whilst having regard to its stakeholders generally.

More information on how the Board has regard for the Group's wider stakeholders can be found on page 66.

Operations

The Board supervises the Group's operations, with a view to ensuring they are effectively managed, that effective controls are in place, and that risks are assessed and managed appropriately.

Financial performance

The Board sets the financial plans, annual budgets and key performance indicators and monitors the Group's results against them.

Strategy

The Board oversees the development of the Group's strategy, and monitors management's performance and progress against the strategic aims and objectives.

Culture

The Board develops and promotes the collective vision of the Group's purpose, culture, values and behaviours.

Information & support

The Board accesses assistance and advice from the Company Secretary. The Board may seek external independent professional advice at the Company's expense, if required, to discharge its duties.

Board Committees

The Audit Committee:

- Monitors the integrity of the Group's financial statements
- Oversees and challenges the effectiveness of the Group's systems of financial and other controls
- Monitors the work and effectiveness of the Group's internal and external auditors and actuaries

The Board Risk Committee:

- Provides oversight and advice to the Board in relation to current and potential future risk exposures of the Group and the future risk strategy, including determination of risk appetite and tolerance
- Responsible for reviewing and approving various formal reporting requirements and promoting a risk awareness culture within the Group

The Remuneration Committee:

- Sets and oversees how the Group implements its remuneration policy
- Oversees the level and structure of remuneration arrangements for senior executives, approves share incentive plans, and recommends them to the Board and shareholders

The Nomination Committee:

- Reviews the Board's structure, size, composition, and balance of skills, experience, independence, and knowledge of the Company
- Leads the process for Board appointments and makes recommendations to the Board
- Provides guidance to management on executive succession planning

The CSR Committee:

- Provides oversight and advice on how the Group conducts its business responsibly, including matters relating to environmental, employee engagement and wellbeing, community involvement, ethics and diversity

The Investment Committee:

- Provides oversight of the Group's investment strategy
- Oversees the management and performance of the Group's investment portfolio

Board and executive management roles

Each Director brings different skills, experience and knowledge to the Company, with the NEDs contributing additional independent thought and judgement. Depending on business needs, the NEDs and the Chairman commit at least three days a month and three days a week respectively to discharging their duties effectively in accordance with their letters of appointment.

The Chairman:

- Guides, develops and leads the Board
- Plans and manages the Board's business
- Ensures the Directors receive accurate, timely and clear information
- Has an individual role profile agreed by the Board, as does the CEO. These profiles clearly define their respective roles and responsibilities and ensure that no one person has unlimited powers of decision-making

The SID:

- Acts as a sounding board for the Chairman and an intermediary for the other Directors when necessary
- Is available to shareholders if they have any concerns they cannot resolve through normal channels
- Leads the Chairman's performance evaluation annually

The NEDs:

- Challenge management in an objective and constructive manner
- Use their wider business experience to help develop the Group's strategy

The CEO

As authorised by the Board, the CEO manages the Group's day-to-day operations and delivers its strategy. The CEO delegates certain elements of his authority to Executive Committee members to help ensure that senior executives are accountable and responsible for managing their businesses and functions.

The Executive Committee

The Executive Committee is the principal management committee that helps the CEO manage the Group's operations. It helps the CEO:

- Set performance targets
- Implement Group strategy
- Monitor key objectives and commercial plans to help achieve the Group's targets
- Evaluate new business initiatives and opportunities

Managing Director Commercial

Managing Director Personal Lines

Chief Operating Officer

Chief Risk Officer

Chief Financial Officer

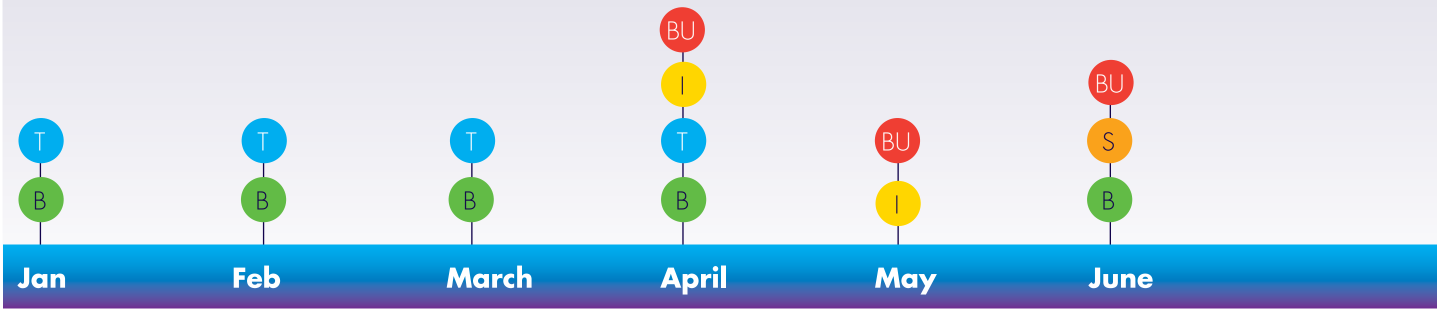
General Counsel

Group Human Resources Director

Biographical details of the Executive Directors and Executive Committee members are shown on pages 62 to 65.

Effectiveness

Board meetings & activity in 2018



Board meetings

The activities undertaken by the Board in 2018 were intended to help promote the long-term success of the Company. Scheduled Board meetings (set out on the timeline above) focused on four main themes in 2018:

Strategy & execution, including: approving and overseeing the Group's key strategic targets and monitoring the Group's performance against those targets; reviewing customer experience and trends and monitoring the Group's performance against external brand metrics; reviewing and approving key projects aimed at developing the business or rationalising costs; considering growth opportunities; and reviewing the individual strategy of key business lines.

Financial performance and investor relations, including: setting financial plans, annual budgets and key performance indicators, and monitoring the Group's results against them; considering the Group's reserving position; approving the solvency II narrative reports; approving financial results for publication; approving main reinsurance arrangements and motor reinsurance renewal; and reviewing broker reports on the Group, alongside feedback from investor meetings.

Risk management, regulatory and other related governance, including: considering the impact of the Ogden discount rate; reviewing and agreeing the Group's Policies; setting risk appetites; approving the ORSA; approving major changes to the Group's partial internal model and seeking to ensure that the Group complies with its regulatory requirements; reviewing the Group's solvency position and forecast; and agreeing the Group's ESG approach.

Board & Board Committee governance, including: receiving reports from the Board's Committees; updating terms of reference for the Committees; implementing an annual review of the Board's and Board Committees' effectiveness; and conducting an annual review of the Group's governance framework.

The co-ordination of the Board meeting content is managed by the Chairman, and supported by the CEO and Company Secretary.

In addition to routine business, the Board considers and discusses key issues that impact on the business as they arise. The CEO and CFO spend a considerable amount of time with the different business areas ensuring that the Board's aims are being correctly disseminated throughout the Group, and that our peoples views and opinions are reported back to the Board.

The NEDs meet with key management outside the Board and Committee fora to obtain a wider view of the Group's activities and attend meetings of the Group's ERB to engage with staff and report their views back to the Board.

Strategy day

The Board sets aside time each year outside the annual Board calendar to hold a strategy day giving the Directors the opportunity to focus solely on strategic matters. In June 2018, the Board held a session offsite to set and monitor progress against the Group's strategy and to discuss the strategic challenges and opportunities the Group faces in the future, including advances in motor and connected home technology.

Board training

The Board is committed to the training and development of Directors to improve their knowledge about the business and the regulatory environment in which it operates. The Company Secretary is responsible for helping the Chairman identify and organise training for the Directors which is tailored to individual needs.

The Company Secretary maintained the training agenda for the Board and its Committees during the year. Training topics during the year included anti-bribery and corruption, growth initiative strategy updates, cyber training, competition law, the forthcoming changes in accounting rules, the IT transformation programme, Green Flag and Capital Model training.

In addition, a series of deep dives into the Group's business areas took place during the year to deepen each Director's knowledge of the business and provide oversight at Board and Committee level.

Board inductions

All new Directors appointed to the Board undertake an induction programme aimed at ensuring they develop an understanding and awareness of our businesses, people and processes, and of their roles and responsibilities as Directors of the Company. The programmes are tailored to suit each Director and include:

- provision of relevant current and historical information about the Company and the Group;
- visits to operations around the Group;
- induction briefings from Group functions; and
- one-to-one meetings with Board members, senior management and the Company's advisers.

Penny James, who joined the Board as CFO-designate in November 2017, completed her induction programme before succeeding John Reizenstein as CFO on 1 March 2018.

Mark Gregory, Gregor Stewart and Fiona McBain, who were appointed as NEDs during the year, each had bespoke induction programmes which included sessions on the Group's strategy, operational businesses, financial performance, capital management, risk management, regulatory landscape and governance framework.

Business unit visits

During 2018, NED visits to operational business units in Bromley, London, Bristol, Leeds, Doncaster and Farnham were arranged to meet the management teams and better understand how the business operates. In September, the Board visited the Group's Bristol site to interact with our people in the HR, Legal Services, Customer Operations and Experience, Business Solutions and Direct Line for Business teams.

Board and Committee effectiveness review

In accordance with the principles and provisions of the Code, the Board's practice is to conduct a thorough review of the effectiveness of the performance of the Directors, the Board as a whole and its Committees on an annual basis, with the input of an external facilitator at least once every three years. In 2018, the Board chose to conduct its effectiveness review in-house as an independent Board effectiveness review had taken place in 2016.

The Company Secretary designed and co-ordinated the process. This involved agreeing a structured questionnaire with the Chairman, SID and the Chairs of the Board's Committees, distributing it to and interviewing the Directors and relevant executives and advisers and preparing reports. The Board and each of its Committees reviewed and discussed the relevant reports.

Respondents were asked whether matters identified as particular strengths in previous years, including the Board's leadership and culture, the openness of debate, the productiveness of proceedings, the quality of information flow to the Board and the relationship between the Board and management, remained positive. Interviews also covered the extent to which the Board's 2018 strategy day had helped the Board to debate and establish the Group's medium-term strategy, the quality of the information received by the Board to monitor the progress of the Group's major technology transformation programmes and the Group's culture.

The Committee questionnaire focused on the clarity of each Committee's role and scope, its composition, the resources available to it, the balance between challenging and supporting management and the quality and timeliness of information supplied to each Committee.

Outcome of the effectiveness review

The Chairman discussed the outcome of the effectiveness review with the NEDs and the CEO, providing them with feedback on their individual performance and contributions. The Board and each of its Committees received and debated their own reports resulting from this exercise. Feedback on the Chairman's performance was provided by the SID, with input from his fellow NEDs.

Based on the responses to the questionnaire and resulting reports, the Directors are satisfied that the Board and each of its Committees operated effectively in 2018. The Directors are also satisfied that they made significant progress in areas identified for potential improvement in 2017.

Whilst the findings of the 2018 effectiveness review were positive, the Board and each of its Committees will focus during 2019 on opportunities for fine-tuning with the objective of further improving effectiveness.

Governance framework and structure

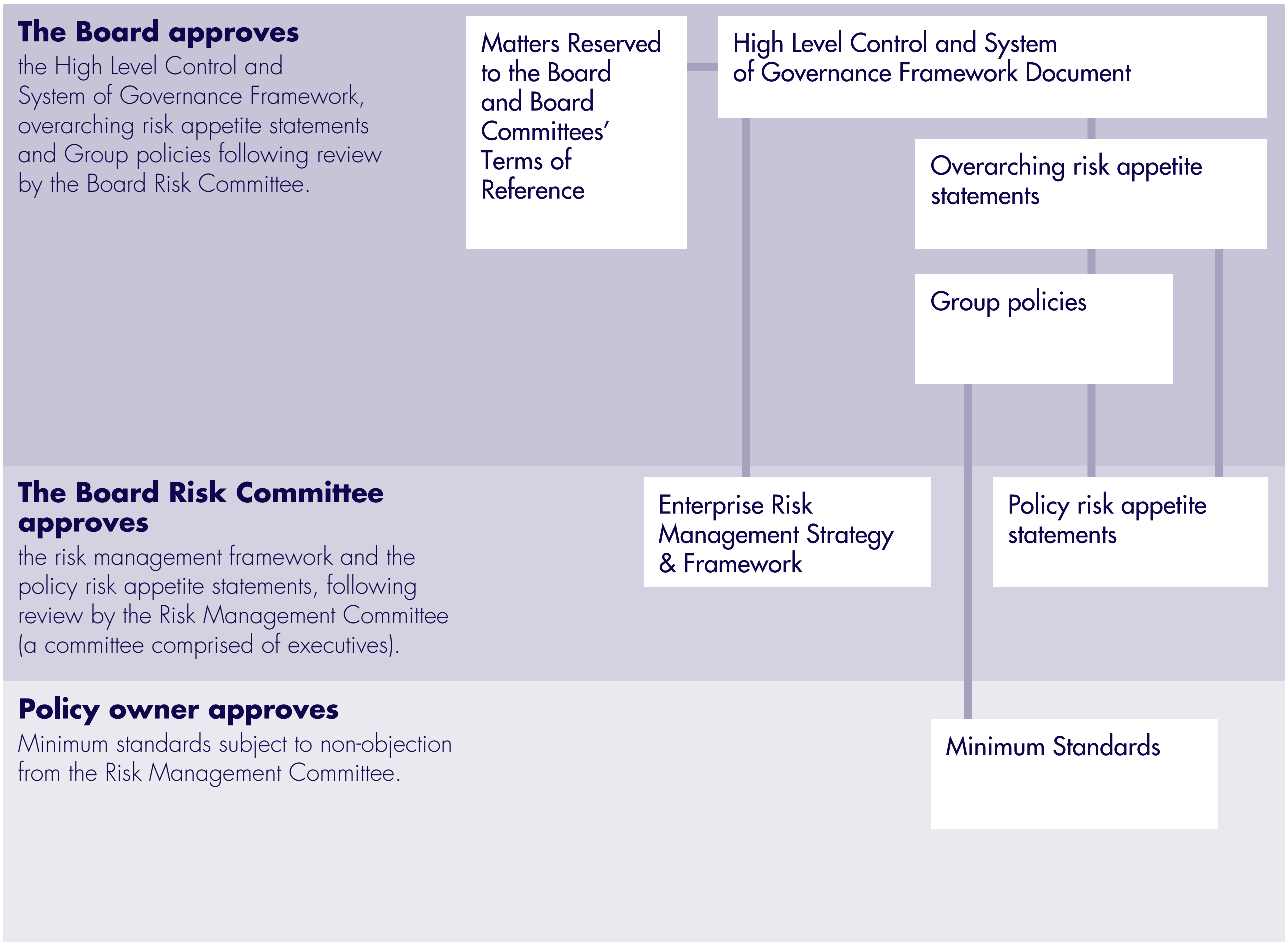
The Board oversees the system of governance in operation throughout the Group. This includes a robust system of internal controls and a sound risk management framework. The Board has established a risk management model that separates the Group's risk management responsibilities into three lines of defence. An explanation of these responsibilities can be found on page 44.

The Group's governance framework is detailed in the Group's High Level Control and System of Governance Framework document. This document details how the Group meets solvency II and PRA requirements to identify Key Functions and to have and maintain a Responsibilities Map in respect of the PRA and FCA Senior Managers and Certification Regime requirements. The Board reviews these documents annually.

The core elements of the governance framework are the:

- Matters Reserved to the Board and the Board Committees' Terms of Reference;
- High Level Control and System of Governance Framework document;
- Risk appetite statements, which are described on page 44;
- Enterprise Risk Management Strategy and Framework, which is described on page 45;
- Group policies, which address specific risk areas and inform the business how it needs to conduct its activities to remain within risk appetite; and
- Minimum Standards, which interpret the Group policies into a set of operational requirements that can be implemented throughout the Group.

The diagram below summarises the split of responsibilities for the different parts of the Group's governance framework.



Conflicts of interest

The Company's Articles of Association allow the Board to authorise matters where there is, or may be, a conflict between the Group's interests and the direct or indirect interests of a Director, or between a Director's duties to the Group and another person. This is in accordance with the Companies Act 2006.

Each Director has a duty to avoid conflicts of interest. They must declare any conflict of interest that could interfere with their ability to act in the Group's best interests.

The Board has authorised certain potential conflicts of interest in this way. However, the Board still deals with any actual conflict of interest or duty that might arise. This usually would involve making sure a Director does not participate in a relevant Board or Committee discussion or decision.

To do this, the Company Secretary maintains a register of conflicts and any conflicts that the Board has authorised.

The Board reviews this register at each scheduled Board meeting.

Approach to diversity

The Board and executive management are committed to ensuring that diversity is promoted across all areas of the Group and that everyone is treated fairly, irrespective of their racial or ethnic origin, gender, age, disability, belief or sexual orientation, religion, or educational or professional background. There is a Board approved diversity policy and progress has been made in embedding principles and practices to promote diversity across the Group and to champion the benefits of a diverse and inclusive workforce.

The principles and practices set by the Board and the progress made in broadening the diversity of the Board include:

1. Maintaining at least 30% female representation on the Board

The Board aims to maintain female representation of at least 30% and remains committed to seeking to improve further its position on diversity when appropriate opportunities arise. The Board will continue to appoint the most appropriate candidates based on knowledge, skills, experience and, where necessary, independence. As at the date of this report, female representation on the Board was 42% which exceeds the target set in Lord Davies' Women on Boards Review Five Year Summary to be achieved by 2020 and remains on target with the Hampton-Alexander Review's recommendations for a minimum of 33% of women's representation on boards by 2020.

2. Only engaging executive search firms who have signed up to the Voluntary Code of Conduct for Executive Search Firms on gender diversity and best practice

In its search for candidates, the Board aims to only engage with executive search firms who are signatories to the Voluntary Code of Conduct for Executive Search Firms as recommended by Lord Davies. During the year, the Nomination Committee worked closely with Egon Zehnder which culminated in the appointment of Fiona McBain, Mark Gregory and Gregor Stewart. Egon Zehnder is a signatory to the Voluntary Code and has no other connection to the Company.

The search process for the replacement CEO, which began in 2018 and culminated in the appointment of Penny James with effect from 9 May 2019, involved engaging MWM Consulting, which is also a signatory to the Voluntary Code and has no other connection to the Company.

Further information regarding the Group's approach to diversity including the process for Board appointments and reappointments can be found on pages 83 and 84 of the Nomination Committee report.

Senior management gender diversity

The Board remains committed to ensuring that high-performing women from within the business and from a variety of backgrounds, who have the requisite skills, are given the opportunity to progress their career internally.

The Group is a signatory to the Women in Finance Charter which aspires to see gender balance at all levels across financial services firms. The Group is committed to seeking to increase female representation at senior management level to 30% by the end of 2019. As at 31 December 2018, women represented 28% of the Group's senior management population. The charts on pages 58 and 59 provide a clearer picture of the diversity of the Board, senior managers and employees.

The Board continues to support Group-wide diversity initiatives, including succession planning programmes, to broaden and strengthen female talent at middle management level. Other key 2018 gender diversity initiatives included: the promotion of flexible working; a partnership with the EveryWoman network which helps organisations enhance the potential of female talent; and mentoring schemes and associated development programmes for high-potential female candidates.

Additional 2018 diversity initiatives

The Board acknowledges that diversity includes but is not limited to gender and aims to increase demographic and philosophical differences at Board level and throughout the Group.

The Board advocates the importance of cultural and ethnic diversity and aims to increase the ethnic diversity across the Group including at Board and senior management level. The Board and senior management continue to support the DNA network which champions diversity and inclusion within our organisation through strands relating to generational divide, unconscious bias, belief, Black, Asian and minority ethnics, gender, sexual orientation, disability, working families and neuro-diversity.

The Board has oversight of diversity initiatives carried out through the remit of the CSR Committee, which received regular updates on the 'build an inclusive culture' strand of our CSR strategy during 2018. Further details on diversity initiatives can be found in the People and culture report on page 58 and in the CSR Committee report on page 85.

Nomination Committee

On behalf of the Board, the Nomination Committee assesses the NEDs' independence, skills, knowledge and experience annually. The Board concluded that every current NED was independent, continued to contribute effectively, and demonstrated they were committed to the role. The Board is also satisfied that the Chairman's external appointment as Chairman of Close Brothers Group plc set out on page 62 does not restrict him from carrying out his duties effectively.

Jane Hanson and Mike Biggs have served on the Board since December 2011 and April 2012 respectively. At the Board's request, they have agreed to continue serving as NEDs and resolutions for their re-election as Directors will be proposed to the 2019 AGM. The Board is satisfied that Jane and Mike remain independent in judgement and character, continue to make a significant contribution to the proceedings of the Board and its Committees and that the extension of their terms of appointment will provide valuable continuity as work on refreshing the Board progresses.

You can find out more about these activities and the Nomination Committee's work during the year on pages 83 to 84.

Accountability

An explanation of how the Board complies with the Code in relation to accountability is set out below, except for the following matters, which are covered elsewhere in the Annual Report & Accounts:

- how the Company seeks to generate value over the long term is explained in the business model on pages 22 and 23, and the strategy for delivering Company objectives is on pages 19 to 21; and
- how the Board has assessed the Group's longer-term viability and the adoption of the going concern basis in the financial statements is on pages 49 and 121.

The Board has delegated responsibility to the Audit Committee to oversee the management of the relationship with the Company's External Auditor. You can find details of the Audit Committee's role, activities and relationship with the External Auditor in the Committee report on pages 78 to 79.

Responsibility for preparing the Annual Report & Accounts

The Board's objective is to give shareholders a fair, balanced and understandable assessment of the Company's position and prospects and business model and strategy. The Board is also responsible for maintaining adequate accounting records and seeks to ensure compliance with statutory and regulatory obligations.

You can find an explanation from the Directors about their responsibility for preparing the financial statements in the Statement of Directors' responsibilities on page 121. The Company's External Auditor explains its responsibilities on page 129.

The Directors confirm that they consider that the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provide the information that shareholders need to assess the Group's position and performance, business model and strategy. In arriving at this conclusion, the Board was supported by a number of processes, including the following:

- management drafted the Annual Report & Accounts to ensure consistency across sections, and a steering group comprising a team of cross-functional senior management provided overall governance and co-ordination;
- a verification process, to ensure the content was factually accurate;
- members of the Executive Committee reviewed drafts of the Annual Report & Accounts;
- the Company's Disclosure Committee reviewed an advanced draft of the Annual Report & Accounts; and
- the Audit Committee reviewed the substantially final draft of the Annual Report & Accounts, before consideration by the Board.

Risk management and internal control systems

The Board oversees the Group's risk management and internal control systems. It has complied with the Code by establishing a continuous process for identifying, evaluating and managing the principal risks the Group faces.

The Board has established a management structure with defined lines of responsibility and clear delegation of authority. This control framework cascades through the divisions and central functions, detailing clear responsibilities to ensure the Group's operations have appropriate controls. This includes controls relating to the financial reporting process.

The frameworks for risk management and internal control were in place for the financial year under review and up to the date of this report. They are regularly reviewed by the Board and comply with the Financial Reporting Council's updated guidance on Risk Management, Internal Controls and Related Financial and Business Reporting.

The Group operates a Three Lines of Defence model. You can find out more about this in the Risk management section on page 44.

The Board, with the assistance of the Board Risk Committee and the Audit Committee as appropriate, monitored the Company's risk management and internal control systems that have been in place throughout the year under review, and reviewed their effectiveness. The monitoring and review covered all material controls, including financial, operational and compliance controls. The Board and its Committees are overseeing the programme of activity to upgrade and better integrate the major IT systems within the Group's technology infrastructure, including focusing on developing future capability for both customers and our people and monitoring risks relating to IT systems' stability, cyber security and the internal control environment.

The Board was also supported in its review of the annual Control Environment Certification process. As part of this, each directorate self-assessed its risks and whether its key controls were appropriate and effective. The Risk and Group Audit functions reviewed and challenged these findings. The Group then combined the overall findings into a Group-level assessment, which the CEO approved. The process included reporting on the nature and effectiveness of the controls, and other management processes that manage these risks.

The Board Risk Committee regularly reviews significant risks and how they might affect the Group's financial position; comparisons to agreed risk appetites; and what the Group does to manage risks outside its appetite.

The Group Audit function supports the Board by providing an independent and objective assurance of the adequacy and effectiveness of the Group's controls. It brings a systematic and disciplined approach to evaluating and improving the effectiveness of its risk management, control and governance frameworks, and processes.

The Directors acknowledge that any internal control system can manage, but not eliminate, the risk of not achieving business objectives. It can only provide reasonable, not absolute, assurance against material misstatement or financial loss.

On behalf of the Board, the Audit Committee regularly reviews the effectiveness of the Group's internal control systems. Its monitoring covers all material controls. Principally, it reviews and challenges reports from management, the Group Audit function and the External Auditor. This enables it to consider how to manage or mitigate risk in line with the Group's risk strategy.

Assessing principal risks

The Board determines the nature and extent of the risks that it is willing to take to achieve its strategic objectives. The Directors robustly assessed the principal risks facing the Company, including risks that would threaten its business model, future performance, solvency or liquidity. You can find a description of these risks, and their management or mitigation, on pages 46 and 47.

This confirmation is based on the Board Risk Committee's twice-yearly review and challenge of the Group's Material Risk Assessment and the Board's review and approval of the Group's risk appetite statements. The Risk Assessment identifies risks quantified as having a residual risk impact of £40 million or more based on a 1-in-200 years likelihood. The quantifications are produced through stress and scenario analysis, and the capital model. Each directorate's bottom-up risk identification and assessment supplements the Risk Assessment. The Risk Assessment also plays a key role in developing the ORSA and assessing the Group's strategic plan.

Remuneration

The Board has delegated responsibility to the Remuneration Committee for the remuneration arrangements of the Group's Executive Directors and Chairman. It recommends and monitors the remuneration level and structure for senior executives. You can find out more about this in the Directors' remuneration report starting on page 88.

Relations with shareholders

The Board believes that engaging regularly with the Company's shareholders is vital to the Group's success. Communicating and engaging with investors means the Board can express clearly its strategy and performance and receive regular feedback from investors. It also gives the Company the opportunity to respond to questions and suggestions.

During 2018, the Board received regular updates from the Executive Directors, the Investor Relations team and the Company's corporate brokers on the views of its shareholders and other investors.

The Chairman, SID and NEDs are available to attend meetings with major shareholders at their request. In 2018, the Chairman met some of the Company's major shareholders and discussed corporate governance topics including executive remuneration.

It is open to all shareholders to raise any issues they wish with the Chair of the Remuneration Committee. As part of the development of the revised remuneration policy for Executive Directors which was approved by shareholders at the Group's 2017 AGM, the Chair of the Remuneration Committee led a wide-ranging consultation through engagement with proxy advisers, regulators and shareholders on corporate governance matters including executive remuneration.

During 2018, the CEO and the CFO met with key shareholders following announcements of results and reported shareholders' views back to the Board.

The Investor Relations team helps the Directors to communicate with investors. The Directors, in conjunction with senior management and the Investor Relations team, participated in varied forms of engagement, including investor meetings, seminars and conferences throughout the year. Management hosted analysts at its Bristol offices in October 2018 to bring to life the Group's various customer-centric and agile ways of working.

The CEO and CFO hosted conference calls for the Group's quarterly results and presentations for its 2017 full year results in February 2018 and its 2018 half year results in August 2018. In addition, the CEO and CFO provided a short video summarising the key messages of the Group's 2017 full year results which is available on the Company's website.

We communicate with our debt investors through regular announcements and the debt investor section of our website which contains bond information, credit ratings and materials relating to the Group's year-end reports, and information about our long-term debt maturity profile so investors can see the related future refinancing needs of the Group.

The Directors, in conjunction with senior management and the Investor Relations team, met with debt investors in the course of the Group's normal investor conferences and roadshows throughout 2018. In addition to this, the CFO hosted a meeting with debt investors in September 2018.

Annual General Meeting

The Board sees the Company's AGM as a good opportunity for private shareholders to talk directly with the Board. All shareholders can attend the AGM if they wish. All Directors attended the AGM in 2018.

At the AGM, the CEO presents the Group's financial results. The Chairman then invites shareholders to ask questions about the meeting's business, before proposing the AGM's formal business. All Directors who wish to continue to serve will be put forward for election or re-election at the AGM. The Chairman, the Committee Chairs and the remaining Directors and members of the Executive Committee are also available to talk with shareholders at the end of the meeting.

The Articles of Association of the Company and the letters of appointment of the NEDs and the Chairman are available for inspection at the Company's registered office and AGM.

The outcome of the resolutions put to the AGM, including poll results detailing votes for, against and withheld, are published on the London Stock Exchange's and the Company's websites once the AGM has concluded.

Audit Committee report

Membership, attendance and responsibilities of the Committee can be found on pages 67 and 68.

GREGOR STEWART
CHAIR OF THE AUDIT COMMITTEE

Areas of focus in the reporting period

- The Committee reviewed how, International Financial Reporting Standard ("**IFRS**") IFRS 17 'Insurance Contracts', which relates to recognition, measurement, presentation and disclosure of insurance contracts, is expected to apply to the Group for annual reporting periods beginning on or after 1 January 2022. It is expected to have a significant impact on accounting for insurance contracts. The Committee received training dedicated to the key aspects of IFRS 17 and the likely areas of impact on the Group.
- The Group initiated a change programme to transition to IFRS 9 and IFRS 17. As part of the programme the Group's ledger system will be upgraded. The change programme will review finance processes to deliver operational benefits alongside the transition to IFRS 17.
- The Board delegated oversight of the changes to the financial reporting system to the Committee. Throughout 2018 the Committee received updates on the programme and the implications of the new IFRSs on the financial statements.
- The impact of the change in the methodology for setting the Ogden discount rate on reserves following the Civil Liability Act 2018 receiving Royal Assent and the related sensitivity analysis were considered by the Committee.

Committee skills and experience

Gregor Stewart was appointed Chair of the Committee in May 2018. In line with the Code, all members of the Committee are independent, and the Audit Committee as a whole is deemed to have competence relevant to the insurance and financial services sectors in which the Group operates.

All Committee members are members of the Institute of Chartered Accountants in England and Wales, with the exception of Gregor Stewart who is a member of the Institute of Chartered Accountants of Scotland. They also have recent and relevant financial experience across a number of different insurance businesses, enabling them to contribute diverse expertise to the Committee's proceedings. To keep their skills current and relevant, in addition to Board training, members of the Committee have received training during the period on matters including IFRS 17 and solvency II technical provisions.

Main activities during the year

At each scheduled Committee meeting, the Committee received reports on financial reporting, reserves, internal controls and Group Audit, except at the December 2018 meeting where the focus was on pre-year-end financial matters. You can find out more about this in the following sections.

Financial reporting

The Committee considered the integrity of the Group financial statements and all external announcements relating to its financial performance. In 2018, this included the Group's 2017 Annual Report & Accounts, the Solvency and Financial Condition Report and its 2018 Half Year Report.

The Committee followed a review process before recommending the reports to the Board which focused on the choice and application of significant accounting policies, emphasising those requiring a major element of estimation or judgement. The review also considered the going concern assumptions and viability statement in the Annual Report & Accounts, valuation of assets and impairment reviews, reserving provisions, non-recurring period-specific transactions and clarity of disclosures.

The Committee reviewed and concluded that the Annual Report & Accounts taken as a whole was fair, balanced and understandable and provided sufficient information to enable the reader to assess the Group's position and performance, business model and strategy.

When considering the 2018 Annual Report & Accounts, the Committee focused on the significant judgements and issues which could be material to the financial statements. These included the matters set out in the table on page 77.

The Committee challenged the judgements being made and also discussed these matters with the External Auditor.

Reserves

The Committee reviews and challenges the key assumptions and judgements, emerging trends, movements and analysis of uncertainties underlying the estimate of reserves. These assumptions and judgements are informed by actuarial analysis, wider commercial and risk management insights, and principles of consistency from period to period. After reviewing the reserves, the Committee recommends them to the Board.

Significant issues

Matter considered	Description	Action
Insurance reserves valuation	The Committee reviewed the level of reserves of the Group. As part of its review, the Committee considered the estimate of reserves, taking into account certain trends and risks as well as management judgement where higher confidence, knowledge and experience can be applied. The Committee also obtained insight from an independent actuarial review of the reserves. Further information on reserves is provided on pages 76 and 77.	In 2018, the Committee reviewed and challenged the level of reserves. In addition, it monitored developing trends in risks that could materially impact them. On an ongoing basis it received updates from the Actuarial Director on how estimates of reserves matched the claims paid.
Ogden discount rate	The Committee considered the process, estimates and judgements made in recommending the new Ogden discount rate. The Civil Liability Act 2018 received Royal Assent on 20 December 2018. The Act details how the UK Government will set the rate used in the assessment of damages for large bodily injury claims. The Actuarial Director considered the new discount rate setting process, after looking at information published by the UK Government on the factors which would be considered when the new rate was set. The Actuarial Director proposed that the rate used by the Group in assessing the level of reserves be changed from minus 0.75% to 0%.	The Audit Committee approved the Actuarial Director's proposal to change the rate used in assessing the level of reserves. In addition, the Committee reviewed the implementation process. The application of the new reserving rate led to a release of £55 million reserves. The Committee continues to monitor the factors that impact the Ogden discount rate and a new rate will be set in accordance with the Act by the middle of 2019.
Valuation of investments not held at fair value	The Committee considered reports on the estimates and judgements applied to the carrying value of the Group's investments that are not held at fair value and the basis for the valuation. These assets are principally comprised of infrastructure loans, commercial real estate loans and private placement bonds held within the investment portfolio. Information was provided to the Committee on a regular basis to support the value recognised in the accounts.	In 2018, the Committee considered major accounting estimates and judgements in respect of assets held at fair value and was satisfied with the carrying value of investments and the basis for their valuation.
Valuation of intangible assets	The Committee considered the valuation of intangible assets. These mainly related to investment in the Group's IT systems and capabilities in respect of projects which are aimed at improving the digital offering, customer experience and operational efficiency. Reports were presented to the Committee covering the assumptions and judgements made in arriving at a valuation of these assets.	In 2018, the Committee considered major accounting estimates and judgements in respect of the valuation of intangible assets and was satisfied that the assets did not warrant any further impairment.

The Committee also considered an appropriate balance between internal and external actuarial review. An external actuarial review of the reserves was carried out by PricewaterhouseCoopers LLP ("**PwC**") for the Directors of the Company. The appointment of consultants to provide actuarial reviews of reserves is subject to approval by the Committee.

Internal control and Group Audit

During the year, the Committee reviewed the adequacy and effectiveness of the Group's internal control systems. The Group's financial reporting control framework is part of the wider internal controls system. It addresses financial reporting risks. The Board delegates supervision of the framework to the Committee while the CFO is responsible for the framework's operation on a day-to-day basis. During 2018, the Committee received regular reports on control deficiencies, compensating controls and the mitigating actions taken by management.

The Committee oversees Group Audit's work and seeks to ensure industry best practice is adopted appropriately. The Group Head of Audit's primary reporting line is to the Chair of the Committee. The secondary reporting line, for day-to-day administration, is to the CFO. Group Audit provides the Committee with independent and objective reports on the adequacy and effectiveness of the Group's governance, risk management and internal controls. The Committee approves Group Audit's annual plan and receives quarterly reports detailing internal audit activity, key findings, management responses, and proposed action plans. Group Audit also monitors that the most significant actions are completed. The Committee approves the Group Audit Charter, which is reviewed annually.

During 2018, following a tender process, the Committee appointed PwC to carry out an external quality assessment of Group Audit in accordance with guidelines issued by the Chartered Institute of Internal Auditors. The scope of the assessment was to assess Group Audit against the CIIA requirements, including the Effective Internal Audit in Financial Services Code in the Financial Sector and best practice. The assessment concluded that the function has achieved the highest rating of compliance with CIIA standards and the CIIA Financial Services Code. A number of recommendations were made by PwC to support the function in continuing to evolve and keep pace with the future challenges and expectations it faces both internally and externally. The Committee endorsed the report and recommendations for continuing improvement and the findings have been incorporated into an action plan. In addition, the Committee concluded that the function had appropriate resources.

Additional information

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that in 2018 it received sufficient, reliable and timely information to perform its responsibilities effectively.

The Actuarial Director, external actuarial advisers, External Auditor and Group Head of Audit meet privately with the Audit Committee, in the absence of management.

The Chair reports on matters dealt with at each Committee meeting to the subsequent Board meeting.

External audit

Deloitte LLP ("**Deloitte**") has served as the Company's Auditor since 2000. Before listing, the Group was audited by Deloitte as a division of RBS Group. The Committee is responsible for overseeing the External Auditor and agreeing the audit fee, as well as approving the scope of the External Auditor's annual plan.

The current audit partner is Mr Colin Rawlings, FCA, who was first appointed for the 2016 audit. The Committee has reviewed the latest public report on Deloitte, issued by the FRC Audit Quality Review Team, and has discussed the findings with Mr Rawlings and made enquiries as to how those findings relevant to the Group have been addressed.

The Financial Reporting Council's Audit Quality Review team reviewed the audit of the 2017 financial statements of the Group's principal subsidiary as part of their 2018 annual inspection of audit firms. The inspection covered selected aspects of the audit and focused on identifying areas where improvements were required. The Committee received a full copy of the report and noted that there were no areas for improvement identified. In addition, the AQR team identified areas of good practice within the audit areas they reviewed. Having considered the report and discussed it with the audit partner, the Committee was satisfied that there was nothing noted which might have a bearing on the audit appointment.

External Auditor tenure

During the year, the Committee discussed the position on its external audit services contract and examined a number of options regarding the timing of tendering for the external audit, including the mandatory rotation of the Group's audit firm. This took into account the reforms of the audit market by the Competition and Markets Authority and the EU, under which Deloitte can continue as the Company's External Auditor until 31 December 2023. The Committee considered whether it was appropriate to tender the external audit contract for the year ending 31 December 2020 and concluded it was not appropriate. The Committee also confirmed that it will continue to comply with the regulations governing auditor rotation.

When considering the timing of the external audit tender, the Committee took into account the Group's ongoing change programmes including the implementation of a new general ledger, the use of consultants employed by auditing firms in connection with those programmes, audit partner rotation, the impact of IFRS 17 and the best interests of shareholders. Following an assessment of all the factors, the Committee decided that it was not appropriate to tender the external audit contract at this time. The Committee will review the position on an annual basis, but currently anticipates tendering the audit contract after the implementation of IFRS 17 for the 2023 year end to ensure the broadest choice of firms.

There are no contractual obligations restricting the Group's choice of External Auditor.

The Company has complied with the provisions of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Auditor independence and non-audit services policy

The Group has a Minimum Standard in relation to Independence of External Auditors. This establishes parameters for preventing or mitigating anything that compromises the External Auditor's independence or objectivity. The Minimum Standard includes a formal process for the approval of non-audit services by the External Auditor.

During the year the Committee reviewed the non-audit services that could be provided by the External Auditor. It was agreed that, in order to protect the independence of the External Auditor, generally on an on going basis non-audit services should not be provided unless there is a strong, clear and understandable business reason. The Committee is satisfied that the Group has adequate procedures to ensure that the External Auditors are independent and objective.

During the year, the Committee approved fees of £0.7 million to Deloitte for services unrelated to audit work. The following is a breakdown of fees paid to Deloitte for the year ended 31 December 2018.

	Fees £m	Proportion
Audit fees[1]	1.9	70%
Audit-related assurance services	0.1	4%
Other assurance services	0.1	4%
Non-audit fees	0.6	22%
Total fees for audit and other services	2.7	100%

Note:
1. Further information is disclosed in note 10 to the consolidated financial statements.

The non-audit fee of £0.6 million related primarily to assurance activities on IT projects in relation to the development of new systems.

Effectiveness of the external audit process and re-appointing Deloitte as External Auditor

In 2018, the Committee assessed the External Auditor's effectiveness. This was in addition to regularly questioning the External Auditor during its meetings. The Committee assessed the External Auditor through:

(i) a detailed questionnaire completed by key stakeholders;

(ii) discussing matters with the CFO;

(iii) formally reviewing the External Auditor's independence;

(iv) assessing whether the agreed audit plan was fulfilled; and

(v) consideration of the FRC's review of the audit of the Group's principal subsidiary.

After taking into account all of the information available, the Committee concluded that Deloitte had performed its obligations effectively and appropriately as External Auditor to the Group.

The Committee recommended to the Board that the Group re-appoint Deloitte as External Auditor. The Group will put a resolution regarding this to shareholders at the 2019 AGM.

The Board reviewed and approved this report on 4 March 2019.

GREGOR STEWART
CHAIR OF THE AUDIT COMMITTEE

Board Risk Committee report

Membership, attendance and responsibilities of the Committee can be found on pages 67 and 68.

JANE HANSON
CHAIR OF THE BOARD RISK COMMITTEE

Areas of focus in the reporting period

- As the Group continues with its IT transformation programme, the Committee reviewed progress against the plans at each meeting. In 2018, the Committee received and challenged reports from management on the programme plans and considered how these would achieve the planned benefits for customers. The Committee probed and challenged all aspects of the programme including the governance, key risks and assumptions and progress reporting. The Committee obtained objective views from the Risk and Group Audit functions on the programme's progress at each meeting and commissioned a series of external specialist reviews to obtain assurance on the approach being taken.
- In March 2018, members of the Committee and management participated in a strategy session, which considered macro risks and the role of the Committee. The session reviewed developments in areas such as the global economy and the impacts of US and UK fiscal policy, Brexit and the potential impacts on the insurance market. Committee members considered market and regulatory developments, as well as the development and measurement of risk culture, taking into account the Group's ongoing initiatives in these areas. In light of these discussions, the Committee considered its own role with the aim of ensuring continued alignment with the key risks facing the Group.
- The Committee considered medium to long-term risks to the Group to gain assurance that management is taking timely actions to manage risks. The Committee received reports from management on the emerging risks the Group faces and evaluated how the Group could be affected by potential developments. During the year, the Committee reviewed all key risks in the Emerging Risk Register, focusing particularly on political and economic risks, and considered the impacts of autonomous technology on the motor market. The Committee considered climate change and its impact both on the Group's current book of business and the Group's longer-term strategy.
- The Committee considered risks relating to the Group's conduct towards its customers. During the year the Committee reviewed the key themes and topics from the Group's Customer Conduct Committee, which were focused on complaints improvement, vulnerable customers, and improved oversight of offshore and supplier performance. The Committee undertook a deep dive into pricing rating factors including the pricing principles and policies currently in place. This area will be closely monitored giving consideration to appropriate regulatory expectations.

Main activities during the year

Risk monitoring and oversight

At each scheduled meeting, the Committee received a report from the Chief Risk Officer which provided an overview and assessment of the Group's risk profile. It detailed the key activities undertaken by the Risk function to further embed risk management across the Group, provided outputs of regular risk monitoring and details of specific risk issues. The Committee also received details of the Group's current and forward-looking solvency position. The Committee received regular reports regarding the three strategic risk appetite statements: maintain capital adequacy; stable and efficient access to funding and liquidity; and maintain stakeholder confidence.

The Committee monitored the Group's exposure against these risk appetite statements and the lower level risk appetite statements, considered key risk indicators and assessed the key drivers that affected status against risk appetite. The Committee reviewed and questioned the justification of the assessment of certain risks and the robustness of management action plans to address areas close to or outside tolerance. During the year, the oversight of change risk was a central focus for the Committee, which challenged management on progress of both the portfolio and individual programmes.

Risk management and controls

The Committee monitored the Group's risk management and internal control systems, and reviewed their effectiveness. This covered all material risks, including financial, operational and compliance. The Committee reviewed the residual risk position after the operation of controls and considered the effectiveness of any associated mitigating actions and compensating controls. The monitoring and review by the Committee involved examining an assessment of the control environment and material controls at Group level, based on divisional risk and control self-assessments. These assessments had been subject to challenge by the Risk and Group Audit functions.

Material Risk Register

The Committee assessed the principal risks facing the Group, which are listed on pages 46 and 47. The Committee achieved this by reviewing and challenging the Group's Material Risk Register in the context of the Group's risk appetite and through consideration of the risk assessment contained in the Chief Risk Officer's report that was discussed at each scheduled meeting.

Assessment of risk behaviours and attitudes

The Committee reviewed the annual Assessment of Risk Behaviours and Attitudes undertaken jointly by the Risk and Group Audit functions, which covered areas including: tone from the top; decision-making; and risk management framework. The Committee discussed the outputs of the assessment, as well as areas for further improvement, seeking to ensure the appropriateness of the actions identified. The Committee also considered the activities of the Risk function in driving a good risk culture across the Group through mechanisms such as training and its internal communications strategy.

Additionally, the Committee considered other subjects in more detail at each scheduled meeting. These included: compliance and regulatory risk including oversight of the Group's regulatory relationships; operational risk; financial risk, solvency II and capital model; and risk governance.

Customer and conduct

The Group aims to make insurance much easier and better value for its customers by delivering on its commitments, fixing things when they go wrong and ensuring that fairness is a natural outcome of what the Group does. In order to help achieve these aims, the Customer Conduct Committee reviews, challenges and oversees customer and conduct matters across the Group. The purpose of the Customer Conduct Committee is to help ensure that the desired outcomes are achieved for the Group's customers. The Customer Conduct Committee's findings and any recommendations for improvement are provided to the Committee and Board on a regular basis.

The Committee reviewed and challenged reports relating to the Group's conduct towards its customers, seeking assurance that customer outcomes were fair and appropriate and to determine that the Group was operating within its defined conduct risk appetite, as set by the Board.

The Committee undertook a deep dive which focused on rating factors, governance and pricing practices. The Committee challenged management in order to gain assurance that the pricing principles and policies in place were fit for purpose and remained fair to customers. The Committee will monitor closely any changes to regulators' expectations.

Compliance and regulatory risk

During the year, the Committee considered the Group's compliance with regulatory requirements including conduct and financial crime. The Committee approved the annual Compliance Plan which sets out the compliance activities which will be undertaken in the coming year with the objectives of: (i) ensuring compliance; (ii) maintaining an open and co-operative relationship with regulators; and (iii) ensuring the Board and employees understand their regulatory responsibilities.

The Committee continued to monitor and challenge the Group's plans for compliance with the EU General Data Protection Regulation which came into force on 25 May 2018. Following its introduction, the Committee received assurance that the programme had successfully implemented the strategy for compliance and that activity to further enhance the programme would be built into the existing compliance strategy. The Committee reviewed and challenged the outputs from conduct and compliance assurance reviews, including in relation to solvency II compliance.

The Committee reviewed regular updates on regulatory developments and interactions, particularly in relation to the FCA and PRA. The Committee also reviewed the actions being undertaken to ensure compliance with the SM&CR, which included a comprehensive review of the Group's High Level Control and System of Governance Framework document and updating the detailed management responsibilities map. The regime, which came into effect on 10 December 2018, now covers employees who are considered to be performing functions which are of specific importance to the sound and prudent management of the firm. The Committee considered regular reports on the Group's actions to prevent financial crime, including reviewing the annual Financial Crime Report.

The Committee has closely monitored developments from the FCA and the Competition and Markets Authority's work on pricing practices and will remain apprised of the review throughout 2019 as well as of the actions which are being undertaken with the aim of ensuring that the Group continues to maintain fair pricing principles. These actions broadly fall into three categories: governance and accountability; oversight (including data and management information); and vulnerable customers.

Operational risk

The Committee continued to review and challenge IT controls, including those relating to IT systems' stability, cyber security and technology resilience. The Committee assessed the level of prevention, protection and detection controls in relation to cyber risk and the residual risk for each of the IT control areas, taking into account any compensating controls and/or mitigating actions. The Committee challenged the progress made in relation to technology risk, in particular to ensure that plans were in place to ensure the Group took action where IT hardware was due to reach the end of its useful life or would no longer be supported. The Committee also reviewed IT risk appetite statements to gain assurance that these were appropriate and in line with the overarching Group risk appetite.

The Committee received regular updates on the Group's multi-year transformation programmes. The Committee received detailed updates following external reviews of the programmes and challenged management on the progress which had been made so far, as well as on the plans going forward. The Committee continued to monitor and examine the oversight and challenge of the major change initiatives by the Risk function and reviewed the outputs of the assurance work undertaken by the Risk function and Group Audit.

The Committee also considered operational risks and controls in respect of third-party suppliers, operational resilience and offshoring, with the aim of ensuring that these risks were being managed appropriately by management and actions taken where necessary.

Financial risk

At each meeting, the Committee monitored the Group's performance against its capital risk appetite through the Chief Risk Officer's report. Committee members considered financial risks in the strategic plan against risk appetite. Committee members also reviewed and challenged the ORSA process and key content before the report was submitted for approval to the Board. Committee challenges on elements of the ORSA during the year included those in relation to stress testing of the strategic plan, pricing and underwriting risk, internal model validation activity and the appropriateness of contingent management actions.

The Committee reviewed and challenged the stress and scenario testing plan prioritising the importance of certain scenarios. The Committee also examined the outputs of the budget stress tests and the associated management actions, where necessary, required to keep the Group within capital risk appetite.

Throughout the year the Committee received reports on the internal model, including independent validation results and the internal model owners' report. This outlined the scope of the capital model, key outputs, risk drivers, significant parameters, expert judgements and key assumptions. The Committee challenged management on the assumptions in relation to the reinsurance decision-making process in the context of the Group's risk appetite as a result of reviewing the internal model owners' report.

Risk governance

Every year, the Committee reviews and approves the Enterprise Risk Management Framework, which includes details of the Group's Policies and Minimum Standards. The Committee reviewed and challenged each Group Policy as part of the Group's solvency II requirements and recommended them for approval by the Board. The Committee also considered the results of the annual Group assessment of the effectiveness of the internal control environment undertaken by each business division, as well as monitoring controls on an ongoing basis.

The Committee considered, challenged and approved the Annual Risk and Compliance operational plan and the adequacy and objectivity of the Risk function's resources.

Whistleblowing

The Committee reviewed the arrangements by which employees may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters ("**whistleblowing**"). The Committee also reviewed reports relating to whistleblowing including individual cases, anonymised to ensure arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action. The Committee probed management and was satisfied that the whistleblowing process met the necessary standards and that it was adequately designed, operated effectively and adhered to regulatory requirements.

Anti-bribery and corruption

Annually, the Committee considers an anti-bribery and corruption report, which includes an annual risk assessment of the level of anti-bribery and corruption risk to the Group. Following review and challenge, the Committee was satisfied that the Group's policies and procedures on anti-bribery and corruption were fit for purpose and that anti-bribery and corruption risks were managed appropriately.

Additional information

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that in 2018 it received sufficient, reliable and timely information to perform its responsibilities effectively.

In addition to monthly one-to-one meetings with the Chair, the Chief Risk Officer also met privately with the Committee without management being present.

The Chair reports on matters dealt with at each Committee meeting to the subsequent Board meeting.

The Board reviewed and approved this report on 4 March 2019.

Jane C Hanson.

JANE HANSON
CHAIR OF THE BOARD RISK COMMITTEE

Nomination Committee report

Membership, attendance and responsibilities of the Committee can be found on pages 67 and 68.

MICHAEL BIGGS
CHAIR OF THE NOMINATION COMMITTEE

Areas of focus in the reporting period

- During 2018, the majority of the Committee's time was devoted to monitoring and recommending changes to the composition of the Board and its Committees. The Committee led the recruitment of three independent NEDs and reviewed the skills and experience that the Board needs to be able to challenge and support senior management in developing and executing the Group's strategy.
- Following the announcement that Paul Geddes will be stepping down as CEO of the Group in the summer of 2019, the Committee launched an internal and external search for his successor.
- With the aim of improving gender and other diversity in the Group's senior management, the Committee continued to encourage management to grow its talent pipeline, both by developing existing employees and by hiring new talent. This is being achieved by the systematic assessment of potential, bespoke personal coaching and development plans for high-potential employees.

Main activities during the year

CEO succession

At the time of the announcement that Paul Geddes would step down as CEO in the summer of 2019, the Committee revisited the succession plan for the Board and launched the process of identifying his successor, which included refreshing the role profiles, taking into account the Group's medium and long-term strategic and cultural leadership requirements, and the selection and appointment of external executive search specialists.

The Committee appointed MWM Consulting, which is a signatory to the Volutary Code of Conduct for Executive Search Firms, to lead the search and engaged Egon Zehnder and YSC Consulting to assist with the evaluation of the candidates. The appointed specialists have no other connection to the Company. The Committee considered a diverse long list prepared by MWM and, having agreed a shortlist, interviewed a number of internal and external candidates. Following a thorough interview and assessment programme and having obtained regulatory approval, the Committee recommended Penny James as its preferred candidate. The Board accepted the recommendation and agreed to appoint Penny as Chief Executive from the conclusion of the AGM on 9 May 2019. The decision was announced on 26 February 2019. The Company has launched the search for a new CFO.

Board composition

During the year, the Committee: considered the Board's skills and experience; reviewed the structure, size and composition of the Board; reviewed the membership and chairmanship of the Board's Committees; and reviewed NEDs' letters of appointment, terms of appointment and time commitment.

The letters of appointment for the Chairman and NEDs set out the time the Group anticipates that they will commit to their roles. This is at least three days a week for the Chairman and an average of three days a month for the other NEDs depending on business needs.

The Committee guides management in executive succession planning. Further information on how the Group develops our talent pipeline can be found on page 73.

Board and Committee changes

On 1 March 2018, Mark Gregory and Gregor Stewart joined the Board as NEDs and Penny James assumed responsibility as Chief Financial Officer. John Reizenstein and Andrew Palmer retired from the Board following the conclusion of the 2018 AGM and, on 1 September 2018, Fiona McBain joined the Board as a NED.

The Committee monitors the membership of the Board's Committees to ensure that each Committee has a suitable balance of skills as well as taking into consideration the length of service of the members.

Following the conclusion of the 2018 AGM, it was agreed that Gregor Stewart be appointed as Chair of the Audit Committee and a member of the Risk Committee. Mark Gregory was appointed Chair of the Investment Committee and a member of the Audit Committee and Penny James was appointed as a member of the Investment Committee. Danuta Gray was appointed Chair of the Remuneration Committee in place of Clare Thompson. Clare remained a member of the Committee.

Board appointment process

The Committee is responsible for reviewing and recommending to the Board any changes as necessary. During the year, the Committee oversaw the formal, rigorous and transparent process which resulted in the appointments of Mark Gregory, Gregor Stewart and Fiona McBain as NEDs.

For each of their appointments, the Committee produced a detailed brief setting out the required skills and experience of preferred candidates which included significant financial services, coupled with audit or risk, experience. The brief was shared with executive search agencies and the Committee agreed to engage Egon Zehnder, which is a signatory to the Voluntary Code of Conduct for Executive Search Firms, and has no other connection to the Company, to conduct the searches.

Egon Zehnder prepared a list of candidates of appropriate merit from diverse backgrounds for each of the positions. The Committee agreed a shortlist for the roles and a series of interviews took place. Once the preferred candidates had been identified and had given their consent to act as Directors, and following regulatory approval, the Committee recommended the appointment of Mark Gregory, Gregor Stewart and Fiona McBain to the Board subject to regulatory approval.

Electing and re-electing Directors

Before recommending the proposed election or re-election of Directors at the 2018 AGM, the Committee reviewed the independence of NEDs and concluded that all NEDs met the criteria for independence set out in the Code. Mike Biggs was independent when he was appointed as Chairman.

Jane Hanson and Mike Biggs have served on the Board for longer than six years and, in accordance with the Code, the extension of their terms of appointment has been the subject of a particularly rigorous review by the Committee. Mike Biggs, as Chairman of the Board and Chair of the Committee, was not involved in his own review.

The Board is satisfied that Jane and Mike remain independent in judgement and character, that they continue to make a significant contribution to the Board and its Committees, and that they provide valuable continuity to the Board. The Committee recommended to the Board and shareholders that all serving Directors be submitted for election or re-election at the Company's 2018 AGM, with the exception of Andrew Palmer and John Reizenstein, who had decided to step down at the conclusion of the AGM.

As announced on 5 March 2019, Clare Thompson has decided, after serving as a NED for over six years, to step down from the Board at the conclusion of the AGM on 9 May 2019 and, accordingly, will not be submitting herself for re-election.

Diversity

The Board believes that an effective board with a broad strategic perspective embraces a diversity of gender, race, skills, experience, as well as regional, socio-economic, educational and professional background, among other differences. In its search for candidates, the Board aims only to engage with executive search firms which are signatories to the Voluntary Code of Conduct for Executive Search Firms.

In March 2018, the Board adopted a Diversity Policy which sets out the Board's approach to diversity and is available on the Company's website. This policy, which is annually reviewed and monitored by the Committee, is presented to any executive search firm during the selection and appointment process for Board positions. Further information on the Board Diversity Policy and the Group's diversity initiatives can be found in the Corporate Governance report on page 73.

The Board supports the targets set in the Hampton-Alexander Review. As at the date of this report, female representation on the Board was 42% (2017: 36%). The Board remains committed to progressing women into senior roles and aims to increase female representation at executive level through associated development programmes for high-potential females.

The Board also supports the recommendations set out in the Parker Review. It is the Board's ambition to increase cultural and ethnic diversity on the Board by 2021.

The Board reviewed and approved this report on 4 March 2019.

MICHAEL N BIGGS
CHAIR OF THE NOMINATION COMMITTEE

Corporate Social Responsibility Committee report

Membership, attendance and responsibilities of the Committee can be found on pages 67 and 68.

SEBASTIAN JAMES
CHAIR OF THE CSR COMMITTEE

Areas of focus in the reporting period

- The Committee focused on Shotgun, the Group's CSR initiative, aimed at reducing young driver accidents, and noted encouraging evidence that use of the Shotgun app was having a measurable positive influence on young drivers' driving behaviours.
- During the year, management introduced a new initiative to realign Group charitable giving with a single cause: mental health. The Committee supported management in its collaboration with MIND and its partner charity, the Scottish Association for Mental Health.
- The Committee was delighted to see increases in employee engagement scores across the Group, as measured by the annual employee survey and the 2019 Sunday Times list of the 25 Best Big Companies to Work For, in which the Group achieved third place.
- The Group's target for reducing energy usage is 30% by 2020 against a baseline established in 2013. The Committee noted that, in 2018, the Group's energy usage had decreased by 2% compared to 2017, bringing the total reduction against the 2013 baseline to 20%.

Main activities during the year

The Committee monitors the implementation of the Group's CSR strategy through regular updates on the different focus areas and challenges the robustness of, and progress against, targets relating to each strand of the CSR strategy. The Committee also ensures that best practice and thinking across the market are considered as part of the Group's own CSR approach.

The Group launched a new CSR strategy for 2018 which focused on two overarching goals: 'Protecting Britain's road users' and 'Reflecting an ever-changing Britain'. Information on the key strategies for these goals is set out below.

Stop deaths now

During the year, the Committee received regular progress updates on Shotgun. The Committee was pleased that, since its inception in 2015, there had been more than 27,000 downloads of the Shotgun app and 79% of users had experienced an improvement in their overall driving scores. You can find further details on Shotgun in the Responsibility Report on page 54.

Shape the future

During 2018, the Committee monitored the 'shape the future' strategy, which aims to influence the future road safety framework through strategic partnerships. The Committee supports the Group's three-year programme with the road safety charity, Brake, to produce a series of topical survey reports on driver behaviour and attitudes, and the Group's work with the Parliamentary Advisory Council for Transport Safety to investigate whether the lack of seat belt use is leading to road casualties.

Build an inclusive culture

Throughout 2018, the Committee reviewed management's initiative to build an inclusive culture through diversity and inclusion. The Committee supported management's plans to focus on wellbeing and mental health. Priority areas during 2018 included: extending the roll-out of mental health training to all people managers; providing access to resilience workshops and webinars for all employees; and introducing Mental Health First Aiders on every floor of every site to be points of contact for employees who are experiencing a mental health issue or emotional distress.

During the year, management updated the Committee on key statistics in relation to the Group's gender pay gap, and on the work being undertaken to increase the number of women in senior roles. This included the introduction of a progression focused support programme for high-potential females, new recruitment methods for attracting and retaining female talent and the launch of the 'Thrive' initiative, a support community aimed at inspiring the Group's female colleagues. Further details on diversity can be found in the Corporate Governance report on page 73.

The Committee recognises the importance of maintaining the highest standards of ethical conduct and behaviour in our business practice and in the workplace. The Committee examined the content and effectiveness of the Group's Code of Business Conduct to ensure that it reflected the Group's position in relation to CSR and diversity and inclusion.

Support our community

The 'One Day' volunteering initiative, which gives employees paid leave to volunteer in their local community, continued to be an area with great impact. The Committee was pleased to hear that 28% of the Group's employees engaged in some form of volunteering or fundraising activity in Company time during 2018.

The Committee also reviewed the Group's policy on compliance with the Modern Slavery Act 2015 and how third-party suppliers complied with the Act's requirements.

The CSR strategy considers energy use, waste management and resource use within the Group's operations, and environmental and social matters in the Group's supply chain. The Committee reviewed and supported the key 2018 objectives relating to the replacement of relevant plant and equipment at office locations with more energy-efficient equipment, the optimisation of the Building Energy Management System, the introduction of a scheme in the Group's Bromley office to recycle coffee cups and the implementation of further energy saving opportunities in the Group's auto repair centres.

Additional CSR activities

The Committee reviewed and challenged management on key CSR developments and emerging risks throughout 2018. The Committee also monitored and scrutinised the extent and effectiveness of the Group's external reporting of CSR performance, including through preparation for CSR-related questions at the 2018 AGM and engagement with proxy voting advisers regarding CSR-related feedback. The Committee continues to monitor management's evaluation of CSR matters in the context of ESG reporting to ensure that the Group's external CSR position is consistent and appropriate.

The Committee continues to challenge management's approach to CSR initiatives to ensure that it is both authentic and strategic, and that management continues to focus on initiatives with real potential to improve lives.

The Board reviewed and approved this report on 4 March 2019.

SEBASTIAN JAMES
CHAIR OF THE CSR COMMITTEE

Investment Committee report

Membership, attendance and responsibilities of the Committee can be found on pages 67 and 68.

MARK GREGORY
CHAIR OF THE INVESTMENT COMMITTEE

Areas of focus in the reporting period

- Throughout the year, the Committee kept under review the economic and financial implications of the UK leaving the EU. The implications of an orderly transition and 'no deal' exit were considered.
- The positioning and asset holdings in the investment portfolio and the need to balance risk and reward were considered in light of the potential Brexit outcomes.
- An investment framework which included an ESG lens for the Group's investment grade credit portfolios was developed and adopted.

Main activities during the year

Brexit

One of the principal risks considered by the Committee during 2018 was the economic and financial market implications of the UK leaving the EU. For planning purposes, in view of uncertainty about the progress of negotiations with the EU, the implications of both an orderly transition and a 'no deal' exit had to be considered.

Against this background, the Committee considered papers and reports which examined current portfolio diversification, portfolio positioning (duration, liquidity) and the possible range of changes in asset valuations that could be experienced under the orderly transition and 'no deal' exit scenarios. The Committee also debated the benefits of hedging strategies to mitigate changes in asset valuations in addition to the investment portfolio's existing defensive orientation.

The Committee's view was that the positioning and asset holdings within the investment portfolio were proportionate to the need to balance risk and reward. The Committee noted the likelihood of higher cash balances at the end of 2018, reflecting existing defensive positioning within the portfolio and a decision taken in November to not reinvest sterling bond maturities in the short term while monitoring market reactions to the development of a Brexit solution. The Committee's conclusions were reported to the Board during its discussions on the wider implications of Brexit on the business operations and capital position of the Group.

Sustainable investing

At the April and July meetings of the Committee, a framework for including an ESG lens into investment decision-making for the investment grade credit portfolios was debated and agreed.

The Group's future investing framework will incorporate a focus on ESG-weighted indices which will tilt the composition of the portfolio towards higher holdings and weightings of issuers with strong ESG scores. Investment managers will be encouraged to invest more in 'green' bonds where such bonds are available and of comparable credit quality. Limited negative screening will be applied and investments will not be made in companies which carry out activities which the Committee does not consider appropriate.

During the first half of 2019, the changes are expected to be reflected in investment decision-making across all relevant credit portfolios.

Market developments

At each scheduled meeting, the Committee received a market update from the Director of Investment Management and Treasury. The updates covered: economic conditions in the UK, the US and the Eurozone; market levels for key asset classes (notably credit); the outlook for interest rates and inflation; and developing issues viewed as appropriate to be brought to the attention of the Committee. The impact on assets of developments in international trading relations and the weakness of the retail sector were of particular note during 2018. The Committee also monitored the continuing development of interest rate policies set by the Bank of England and the US Federal Reserve and the impact on the hedged yields of US Dollar credit assets held in the portfolio.

Suitability of investment strategy

An annual asset and liability management study and a stressed liquidity analysis were presented to the Committee, informing strategic benchmark allocations and providing part of the context for the addition of new asset classes or exiting a present holding. The Committee approved a small reduction in US credit exposure, a reduction in overall access to liquidity required over a three-month horizon and increases in exposure to commercial real estate loans and Euro credit.

Monitoring investment activity and performance

The Committee received a comprehensive report at each scheduled meeting covering: the financial results from investment activity; aggregate portfolio positioning against strategic benchmarks; performance of each individual portfolio against benchmark; adherence to operational controls; performance of suppliers; and compliance with an agreed framework of risk limits. The Committee invited the managers responsible for the commercial real estate loans portfolio and the infrastructure debt portfolio to present updates on their respective portfolios. The Committee also examined a proposal by management to reduce investment fees through the appointment of a core external asset manager, under whom a number of investment mandates would be consolidated. The Committee met the recommended manager to determine the adequacy of their skills and resources to meet the expanded role towards the end of the year. The Committee was also updated on the change in categorisation of money market funds (used by the Group for cash investments) as the funds move to comply with EU money market reform regulation.

The Board reviewed and approved this report on 4 March 2019.

Mark Gregory

MARK GREGORY
CHAIR OF THE INVESTMENT COMMITTEE

> The Remuneration Committee is committed to aligning Executive Directors' pay to the Group's business strategy and demonstrable success and the interests of our shareholders.

Dear shareholders,

I am pleased to introduce my first Directors' Remuneration Report as Chair of the Remuneration Committee ("the Committee"), for the 2018 financial year. I would like to thank Clare Thompson for her stewardship of the Committee over the last few years.

At Direct Line Group we believe that Directors should be paid fairly for the job they do and the results that they generate. I see the Committee's objectives as:

- Rewarding Directors for results that are generated within the risk appetite set by the Board.
- Setting an appropriate framework for remuneration for the Board with sufficient flexibility so that the Group can attract and retain the best people for the organisation.
- Having oversight of remuneration policies throughout the Group and ensuring all our employees are paid fairly.

In this letter I introduce the items that I think are important or new in the Directors' Remuneration Report. The report is set out in the following sections:

The Remuneration Policy which covers the 2018 report was approved, by a substantial vote in favour of the policy at the AGM in May 2017. Consistent with the regulations, the Directors' Remuneration Policy is next due to be submitted to the Company's AGM for approval in 2020.

Pay outcomes for 2018

All-employee pay in 2018

We could not be successful without the hard work and dedication of our talented people, at all levels of the organisation. It is important to us that we ensure all our people are rewarded fairly and have an interest in the success of the Group.

In 2018 we focused our pay budget specifically on those in lower paid roles, ensuring that all employees with satisfactory performance received a pay increase of at least £650. We also increased minimum salaries across the Group to £17,000 or £18,000 (depending on contracted hours), which were adopted for all roles except apprenticeship schemes. This meant that the average pay increase for employees below Senior Leadership was around 3.2%, but was around 5% for our lowest paid frontline roles. Our minimum salaries were positioned approximately 6% above the Living Wage Foundation rate for non-London roles, and approximately 18% higher than the Government's National Wage at the time.

We want our employees to have ownership of the Group and its success, and in 2018 we issued our fourth all-employee free share award since our IPO. Outside our Senior Leadership, 86% of our people own shares in the Company, thus ensuring alignment at all levels between the work they do and the success in which we share.

Annual Incentive Plan

The Group's diversified product and channel portfolio, disciplined underwriting and our engaged employees have helped us to achieve a commendable profit before tax result of £583 million. For the purpose of the financial element of the Annual Incentive Plan, the profit before tax target excluded the budgeted reserve release related to the expected Ogden discount rate change. The actual profit before tax consequently differed from the statutory IFRS basis by excluding the actual Ogden discount rate related releases made in 2018. The out-turn was slightly ahead of the target leading to a pay-out of 64% of maximum for this element.

Performance across the People measures was particularly strong for the year and the Committee awarded a maximum out-turn for this element. The Customer measures were assessed as being on target. The Committee is pleased to report this year that management have made significant progress on the technology transformation agenda on which the Personal objective was measured, and awarded an out-turn of 70% for this element. Full details on the outcomes for the year are included on pages 96 – 99.

We therefore awarded bonuses of 68% of the maximum to the Executive Directors. In line with the Remuneration Policy, 40% of any AIP award is automatically deferred into a Deferred Annual Incentive Plan award.

Review of the impact of the Ogden discount rate change on the 2016 AIP out-turn

You may recall that, at the time of the approval of the 2016 AIP out-turn, the Government had just announced a change in the Ogden discount rate which materially impacted the financial results for 2016. To align the 2016 AIP out-turn with shareholders, the Committee significantly reduced the AIP out-turn from an anticipated maximum pay-out for the financial element (based on the indicative range used by the Committee for its assessment) to 10% out of the 55% of total bonus opportunity attributable, an approach more conservative than many of the Group's competitors. The government, at the same time, announced that a review of the rate setting mechanism would be undertaken. Given these exceptional circumstances, the Committee agreed to keep its assessment of the 2016 AIP outcome under review to enable the Committee to recalculate the out-turn for the 2016 financial year if the Ogden discount rate was raised or the mechanism for setting it was changed.

On 20 December 2018 the Civil Liability Act passed into law which confirmed the new process for the setting of the Ogden discount rate. Following the introduction of the new rate setting process, the Group considered the Ogden discount rate it uses to calculate its liabilities which led to an increase from minus 0.75% to 0% (pending the Government publishing the final rate which will be set by the middle of 2019 at the latest).

The application of this new discount rate led to a reserve release of £55 million which, together with an earlier associated release in 2017 of £49 million, totalled £104 million of the £217 million originally charged in 2016 as a result of the Ogden rate change.

Following the commitment made by the Committee (and disclosed in the 2016 Remuneration Report), the Committee considered the impact of the Ogden-related reserve releases made since February 2017 in terms of the impact on the 2016 AIP out-turn. Had they been attributed to the 2016 financial year, this would have resulted in a maximum pay-out for the financial element of the AIP and a potential increase to 2016 bonuses of up to 45% of maximum. The Committee reviewed this result in the context of balancing the desire to ensure the outcome was fair to participants while being appropriately aligned with the shareholder experience. In striking this balance it concluded that it was appropriate to make an overall increase of 20% to the bonus payment for 2016 (below the 45% formulaic calculation).

This led to additional payments in March 2019 for Paul Geddes, Mike Holliday-Williams and John Reizenstein for the 2016 AIP. All payments have been made in accordance with the normal policy with 40% deferred into the Group's shares which will vest on the third anniversary of award (March 2022).

Finally, the Committee noted that the Ogden rate change in February 2017 was exceptional in that there had not been a change for over 10 years. Now that the new rate setting mechanism has been implemented, the Committee considers that the impact of future Ogden discount rate changes to be part of the normal management of reserves and so it is unlikely in the normal course of events that special allowance will be made in the AIP out-turn for a change in Ogden discount rate.

Long Term Incentive Plan

The LTIP has two performance measures: RoTE (60% of the total award) and relative TSR (40% of the total award). Awards under the LTIP granted in March and August 2015 vested during 2018.

The Group achieved an average RoTE of 18.1% over 2015, 2016 and 2017 resulting in 100% of the maximum potential vesting of the RoTE element for both awards (60% of the total awards).

The TSR performance periods run from the date of award to the third anniversary of award (as opposed to across the three financial years commencing with the year in which the award was granted as for the RoTE measure). For the March 2015 award the TSR performance was positioned between the median and the upper quintile against its comparator group which resulted in 62% of the maximum potential vesting for this element (24.8% of the total award). Accordingly, this gave a total vesting outcome of 84.8%. For the August 2015 award, the TSR performance was below the threshold requirement of median and therefore no shares vested under this measure. Subsequently the overall vesting outcome for this award was 60%.

Awards under the LTIP granted in March and August 2016 are due to vest during 2019, subject to the Committee's satisfaction that the financial and risk underpins have been met at the end of the vesting period. The RoTE performance period for these awards ended on 31 December 2018. The three-year average RoTE performance for 2016, 2017 and 2018 was 18.5% against a maximum target of 17.5%. Awards under the RoTE element are, therefore, due to vest at 100% of the maximum potential.

In calculating the RoTE achievement, the reported RoTE for 2018 was adjusted downwards to exclude the favourable impact of the capital management exercises executed in the 2017 financial year on the outcome for these awards. The ongoing enhancement to earnings expected in future years has been explicitly recognised by the Committee in setting higher targets than would otherwise be the case.

Consistent with the regulations, due to the different timings of the performance periods for RoTE and TSR, the TSR element of the 2016 awards due to vest during 2019 will be reported separately next year. Accordingly, we have included an estimated value of the RoTE vesting outcomes for 2016's awards plus the TSR vestings from the 2015 awards in the single figure remuneration table for 2018 for the Executive Directors.

UK Corporate Governance Code 2018 and the new CEO pay ratio disclosure

There have been several changes to the UK Corporate Governance Code which affect the remit of this Committee: communication with employees about Directors' remuneration (in addition to the workforce consultation requirements); policy on post-employment shareholding requirements; and the alignment of pension contributions for Directors to those of the workforce. The Committee worked hard to be in compliance with these requirements for when they came into effect on 1 January 2019 and the Committee will report details on how we have met these requirements in our 2020 report. We have also chosen to adopt early the new disclosure requirements on the CEO's pay relative to the wider workforce as part of our efforts to strengthen the transparency in our approach to the alignment of Directors' pay with that of the wider workforce.

Approval of the Directors' Remuneration Report for 2017 at the AGM in May 2018

At the Direct Line Group plc AGM held in May 2018 the resolution approving the Directors' Remuneration Report was passed by 76.6% of the votes cast in favour of the resolution. The resolution, which only required a simple majority to be approved and is advisory in nature, was therefore convincingly approved by shareholders. However, this was significantly lower than the percentage of votes in favour of resolutions that the Company has historically received and as a result the Group have been included on the Investment Association's register of companies that have more than 20% of votes cast against a resolution at a general meeting. All of the remuneration arrangements described within the 2017 report were in line with the Remuneration Policy approved by shareholders at the AGM in 2017. The main issue raised by some of the proxy voting agencies on the Remuneration Report was the increase in remuneration for the new Chief Financial Officer compared with that of her predecessor. Consequently, the proxy voting agencies recommended an automatic vote against the Remuneration Report in 2017.

The Board carried out a thorough recruitment process and identified Penny James as the ideal candidate for the role: after considering the needs of the Group, the role and her experience, the Committee agreed to match the remuneration from her previous employer to secure her services. The Board was satisfied that Penny was the right person for the job and this was considered the only way to bring Penny into the organisation. The Committee Chair and the Board Chair engaged with shareholders to understand any concerns. Shareholders were supportive of the decisions that the Board and Committee had made and understood the reasons for them. Engagement with investors in relation to remuneration will continue with regards to new appointments to the Board.

Approach to pay in 2019

No change to the overall approach to pay is anticipated for 2019. The updated Remuneration Policy will be put to shareholders in 2020.

The MD Personal Lines will be awarded a salary increase of 2.25% from 1 April 2019 in line with the average rate for staff generally. The Committee is satisfied that the increase is warranted based on his performance and the role he performs.

No increase will be awarded to the CEO in view of the fact that he will be leaving the Group during 2019.

The CEO-designate will not receive a salary increase before her appointment as CEO on 9 May 2019 (see below).

No change will be made to either the weightings or the approach to assessment of the metrics under the AIP.

We are not proposing any changes to the performance conditions for the 2019 awards under the LTIP. Likewise the target RoTE scale of 17.5% to 20.5% will remain at the same level as in 2018 and reflects an appropriate performance range in the context of the Group's planned underlying RoTE performance.

Chief Executive Officer

On 26 February 2019, Penny James, the current CFO, was appointed to succeed Paul Geddes as Chief Executive Officer and will become the CEO from the conclusion of the AGM on 9 May 2019. Paul will step down from the Board following the AGM on 9 May 2019 and will leave the Group at the end of July 2019.

In setting Penny's remuneration, we benchmarked her salary against the FTSE 51-100 and positioned her salary below the current CEO's salary level. There will be no change to her participation in the Company's AIP up to a maximum of 175% of salary and the LTIP up to 200% of salary. We have however taken the opportunity to set Penny's pension contribution at 9% of salary (reduced from the existing pension contribution rate of 25% of salary), in line with that of the wider workforce which will be our policy for all new Executive appointments. The Committee will be considering the reduction of pension contribution for all Executive Directors as part of the remuneration policy review during 2019. The details of Penny's remuneration, which will take effect from 9 May 2019, are set out on page 112.

Any payments relating to Paul Geddes' departure will be in accordance with the Remuneration Policy approved by shareholders at the Company's 2017 AGM and will be disclosed in the Directors' Remuneration Report to be contained in the Company's Annual Report and Accounts for the year ending 31 December 2019.

Advisers to the Committee

During the year, the Committee appointed PwC as its independent adviser from 1 January 2019. FIT Remuneration Consultants LLP have been advisers to the Remuneration Committee since the time of the IPO in 2012 and therefore the Committee felt it was appropriate to seek a change of adviser at this time. On behalf of myself and the Committee I wish to extend our thanks to FIT, and John Lee in particular, for their support and counsel over the past years.

Your AGM vote

I hope that having read the information in this report, and considering the performance of the Group during 2018, you will vote in support of the Remuneration Report at the AGM. Should you have any questions about my Committee's report please email our AGM email address shareholderenquiries@directlinegroup.co.uk and I or my team will respond to you.

Yours sincerely

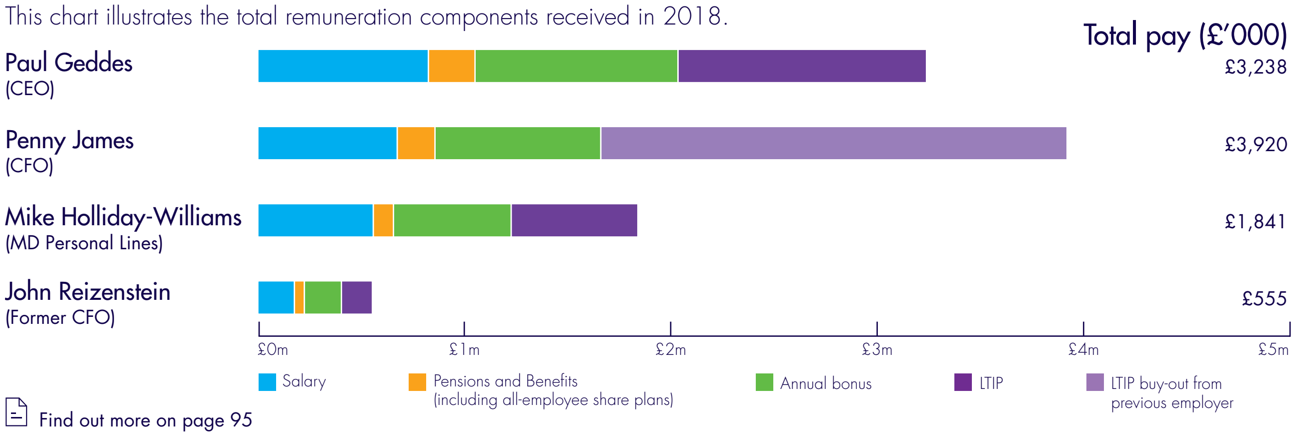
DANUTA GRAY
CHAIR OF THE REMUNERATION COMMITTEE

Remuneration at a glance

Remuneration outcomes for 2018

Executive Directors' total pay

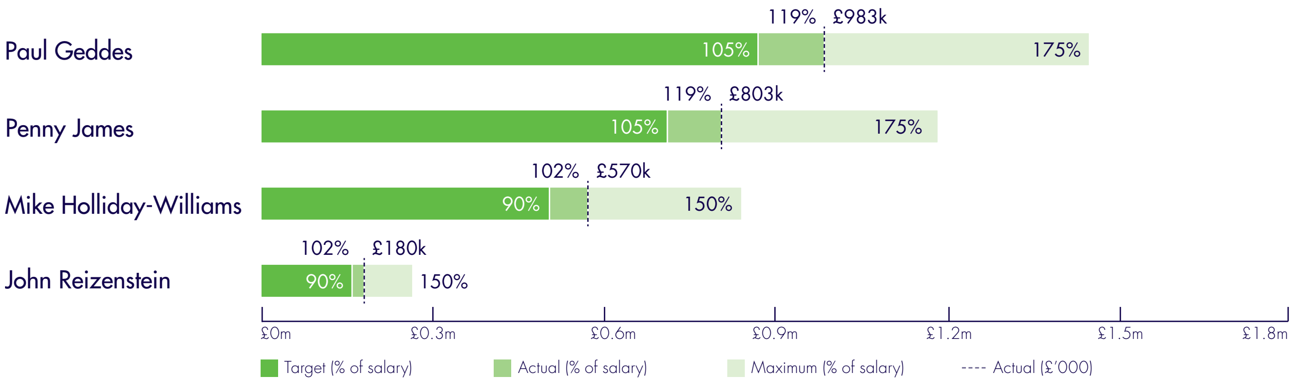
This chart illustrates the total remuneration components received in 2018.



Find out more on page 95

AIP achievement

This chart illustrates the actual amounts earned from the AIP and reflecting performance in 2018. 60% of the amount is payable in March 2019 and 40% will be deferred into shares for three years.

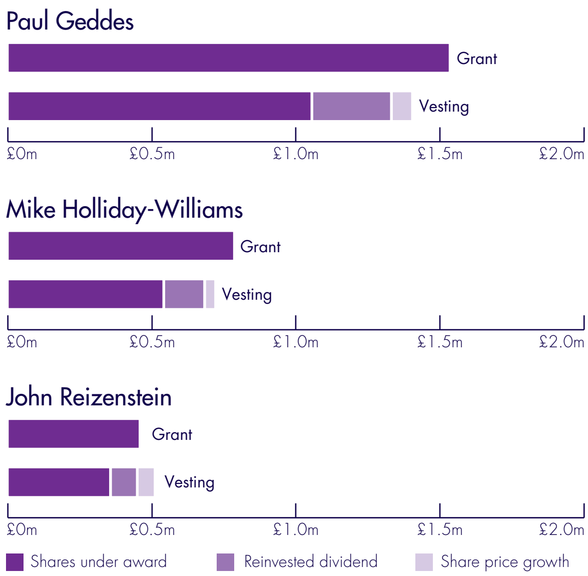


Find out more on pages 96 – 99

LTIP

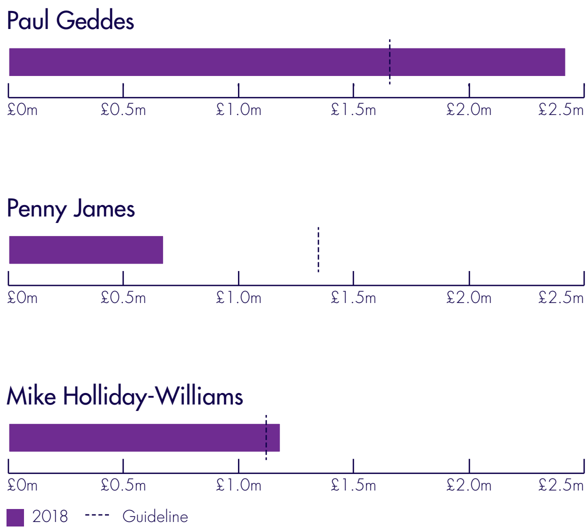
Release of value

This chart illustrates the total value of the 2015 LTIP awards that vested in 2018.



Shareholding at year end

This chart illustrates the number of shares held at the end of 2018 by the Executive Directors against the share ownership guidelines of 200% of salary.



Find out more on pages 100 – 101 and 105

Implementing the policy in 2019

Key feature	Implementation in 2019
Base salary	
– Reviewed annually with any increases taking effect on 1 April – The Committee considers a range of factors when determining salaries, including pay increases throughout the Group, individual performance and market data	– No salary increase for the outgoing CEO – CEO-designate salary to increase to £800,000 (effective from appointment on 9 May 2019) – No salary increase for the CEO-designate at 1 April – New CFO to be appointed – 2.25% salary increase for the MD Personal Lines to £575,242
Pensions	
– CEO and CFO contribution rate of 25% of salary – MD Personal Lines contribution rate of 15% of salary	– CEO-designate pension contribution to be reduced to 9% of salary (effective from appointment on 9 May 2019) – New CFO to be appointed – The pension contribution rate will be in line with that of the wider workforce for all new Executive Director appointments – The reduction of pension contribution for all Executive Directors in line with that of the wider workforce will be considered as part of the policy review during 2019
Annual Incentive Plan	
– Maximum opportunity of 175% of salary for the CEO and the CFO, and 150% for the MD Personal Lines; 40% of the award is deferred into shares, typically vesting after three years and subject to continued employment – At least 50% of bonus is based on financial measures. The Committee considers various non-financial and strategic performance measures. It bases its judgement on the payment outcome at the end of the performance period on its assessment of the level of stretch inherent in targets – Any payment is subject to an additional gateway assessment, including assessing risk factors – Malus and clawback conditions apply	– No change to the maximum opportunity – No change to the weightings or measures used for 2019 – The targets are commercially sensitive and will be disclosed in next year's report.
Long-Term Incentive Plan	
– Awards typically granted as nil-cost options – Awards typically granted every March and August at half the annual level – The Plan allows for awards with a maximum value of 200% of base salary per financial year – Performance is measured over three years and determined by RoTE and relative TSR measures – Awards vest subject to financial underpin and payment gateway – Malus and clawback conditions apply – Awards are subject to an additional two-year holding period following the end of the three-year performance period	– No change to the maximum annual award levels – Nil-cost options will continue to be used for the grants – The current 60% RoTE and 40% TSR mix will continue to apply – A RoTE target range of 17.5% to 20.5% is required for the 2019 awards to vest

Find out more on page 114

Statutory remuneration report

Introduction

We have prepared this remuneration report in accordance with the requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended) (the "Regulations"). The report also meets the relevant requirements of the Listing Rules of the Financial Conduct Authority, and describes how the Board has complied with the principles and provisions of the UK Corporate Governance Code relating to remuneration matters. Remuneration tables subject to audit in accordance with the relevant statutory requirements are contained in the annual Remuneration Report and stated to be audited. Unless otherwise stated, the information within this Directors' Remuneration Report is unaudited.

Annual remuneration report

Remuneration Committee members and governance

The following list details members of the Remuneration Committee during 2018. You can find information about each member's attendance at meetings on page 67. You can find their biographies on pages 62 to 64.

Committee Chair
Danuta Gray[1]
Non-Executive Directors
Mike Biggs
Sebastian James
Andrew Palmer[2]
Clare Thompson

Notes:
1. Danuta Gray was appointed as Chair of the Remuneration Committee with effect from 10 May 2018.
2. Andrew Palmer stepped down from the Board with effect from 10 May 2018.

Advisers to the Committee

The Committee consults with the Chief Executive Officer, the Group Human Resources Director, and senior representatives of the HR, Risk and Finance functions on matters relating to the appropriateness of all remuneration elements for Executive Directors and Executive Committee members. The Chairman, Chief Executive Officer and the Group Human Resources Director are not present when their remuneration is discussed. The Committee works closely with the Chairs of the Board Risk Committee and the Audit Committee, including receiving input from those Chairs regarding target-setting and pay-outs under incentive plans, and whether it is appropriate to operate malus and clawback. The Chair of the Board Risk Committee attended Remuneration Committee meetings on two occasions. The Remuneration and Board Risk Committees can also hold joint meetings to consider matters of common interest.

The Committee retained FIT Remuneration Consultants LLP ("**FIT**") as its independent adviser until the end of 2018. FIT is a signatory to the Remuneration Consultants Group's Code of Conduct. The Committee appointed FIT when preparing for the IPO.

During the year, FIT advised on market practice, corporate governance and regulations, incentive plan design and target-setting, recruitment, investor engagement and other matters that the Committee was considering. FIT did not provide the Company with other services. The Committee is satisfied that the advice FIT provided was objective and independent.

FIT's total fees for remuneration-related advice in 2018 were £110,349 exclusive of VAT. FIT charged its fees based on its standard hourly rates for providing advice.

Following a competitive tender process, the Committee appointed PwC as its independent adviser from 1 January 2019. PwC is a member of the Remuneration Consultants Group and, as such, operates under the code of conduct in relation to executive remuneration consulting in the UK. The Committee is satisfied that the advice received is objective and independent. PwC also provides other advice to the Group covering accounting, tax and immigration services. The total fees (charged on an hourly basis) for the provision of remuneration advice to the Committee in relation to the 2018 financial year were £8,000 exclusive of VAT.

Allen & Overy LLP, one of the Group's legal advisers, also provided legal advice relating to the Group's executive remuneration arrangements. It also provided the Group with other legal services.

Implementing policy and pay outcomes relating to 2018 performance

Single figure table (Audited)

	Salary[1]		Benefits[2]		Annual bonus[3,6]		Long-term incentives[4,7,8]		All-employee share plans[5]		Pension		Total	
£'000	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Paul Geddes	826	807	19	18	983	1,242	1,204	1,770	–	–	206	202	3,238	4,039
Penny James[9]	675	113	14	2	803	1,014	2,259	532	–	–	169	28	3,920	1,689
Mike Holliday-Williams[10]	559	501	14	13	570	721	614	851	–	–	84	75	1,841	2,161
John Reizenstein[11]	177	488	4	9	180	644	150	1,071	0.3	1	44	122	555	2,335

Notes:
1. Salary – the Company operates a flexible benefits policy, and salary is reported before any personal elections are made.
2. Benefits – includes a company car or allowance, private medical insurance, life assurance, income protection, health screening and discounted insurance. The value of benefits in the table above includes all taxable benefits received.
3. Annual bonus – includes amounts earned for performance during the year, but deferred for three years under the DAIP. For more information, see page 106. These deferred awards are not subject to any conditions, except continuous employment. However, awards remain subject to malus and clawback.
4. 2015 LTIP awards RoTE – the expected vesting outcome figures for the RoTE portion of the awards granted under the LTIP in 2015 and reported in 2017 have been updated. These updates are based on the actual vesting of the RoTE portion of the awards and a share price of £3.75300 and £3.34400 on 25 March 2018 and 26 August 2018 respectively, compared to the three-month average share price of £3.65557 used in reporting this figure in the 2017 report. The revised figures include the actual number of dividends accrued on this portion of the award at vesting. This results in an adjusted reportable decrease of approximately £292,700 for Paul Geddes, £177,160 for John Reizenstein, and £149,439 for Mike Holliday-Williams with a corresponding decrease of the single figure for 2017 reflected in the table above. Further information on LTIP awards can be found on pages 107 to 108.
5. SIP – includes the value of matching shares under the SIP.
6. The 2017 annual bonus figure for Penny James includes a payment of £840,841 made in lieu of the bonus forfeited at her previous employer and is pro rated for the period 1 January to 31 October 2017 (before Penny joined the Group). This is in line with the estimated payment shown in last year's report and therefore this figure has not been updated.
7. The 2017 estimated long-term incentive figure for Penny James in respect of the first tranche of her buy-out awards, which vested in May 2018 and which was reported in 2017, has been updated. This value is based on an actual level of vesting of 95.835% and the share price on 2 May 2018 of £3.658. Details of this award are disclosed on page 109.
8. The 2018 long-term incentive figure for Penny James relates to an estimated amount in respect of the second and final tranche of her buy-out awards, disclosed on page 109, which vests in April 2019. The award is subject to the achievement of performance targets, ending in the 2018 performance year, that relate partly to the performance of the Company and partly to the performance of her previous employer. The value of this award is based on an expected level of vesting of 97.335% and a three-month average share price to 31 December 2018 of £3.20042. The actual vesting outcome will be confirmed in next year's report once actual performance and the vesting date share price are known. Further details are set out on page 101.
9. Penny James was appointed to the Board on 1 November 2017 and also became employed on that date.
10. Mike Holliday-Williams was appointed to the Board on 1 February 2017. His salary, benefits and pension for 2017 have been pro rated accordingly.
11. John Reizenstein stepped down from the Board at the AGM on 10 May 2018. His remuneration for the purposes of this table has been pro rated accordingly, with LTIPs vesting by reference to performance conditions met while he was on the Board in 2018. Details of John's salary, pension and benefits paid following his cessation as an Executive Director on 10 May 2018 until the date of his retirement on 7 September can be found on page 112.

Each Executive Director has confirmed they have not received any other items in the nature of remuneration, other than those already disclosed in the single figure table.

2016 single figure table restated (Audited)

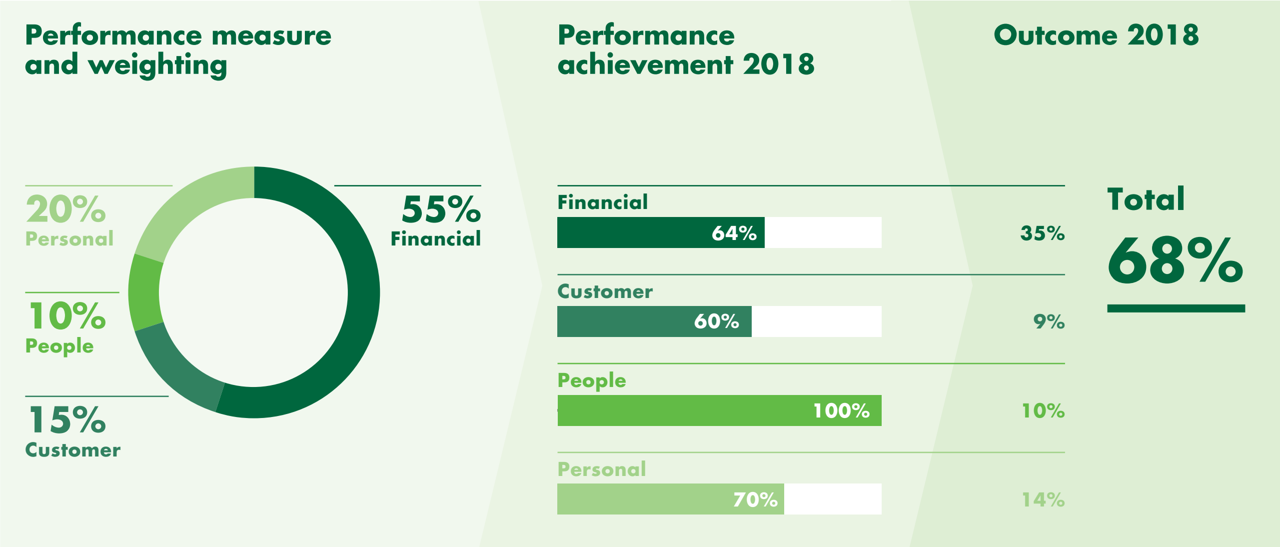
As set out in the Chair's letter, the Committee concluded that an adjustment to the 2016 profit out-turn as a result of the impact of reserve releases that are due to the Ogden rate changes is appropriate. This led to additional payments in March 2019, in relation to the 2016 AIP, representing 20% of maximum opportunity of the original awards. The 2016 single figure table is therefore restated below to reflect this. All additional payments in relation to the 2016 AIP have been made in accordance with the normal policy with 40% deferred into the Group's shares which will vest on the third anniversary of award (March 2022).

	Salary		Benefits		Annual bonus		Long-term incentives		All-employee share plans		Pension		Total	
£'000	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Paul Geddes[1]	790	771	19	18	871	1,120	2,471	2,693	–	–	197	193	4,348	4,795
John Reizenstein[2]	478	467	10	15	452	602	1,495	1,630	1	1	119	117	2,555	2,832
Mike Holliday-Williams[3]	–	–	–	–	546	–	–	–	–	–	–	–	–	–

Notes:
1. The revised 2016 annual bonus figure for Paul Geddes relates to an adjustment of 20% of maximum opportunity of the original award of £594,287, resulting in an increase of £276,413.
2. The revised 2016 annual bonus figure for John Reizenstein relates to an adjustment of 20% of maximum opportunity of the original award of £308,294, resulting in an increase of £143,393.
3. Although Mike Holliday-Williams was not an Executive Director during 2016, his restated annual bonus has been included above for completeness. This represents an adjustment of 20% of maximum opportunity of the original award of £385,074, resulting in an increase of £160,448.
4. The original out-turn and explanation of the 2016 AIP can be found on page 88 of the 2016 Annual Report and Accounts.
5. The 2016 figures are as disclosed on page 79 of the 2017 Annual Report other than in relation to the restated bonus.

Annual Incentive Plan outcomes for 2018 (Audited)

The chart illustrates the final assessment of the level of achievement under the AIP and total outcome approved by the Remuneration Committee.



Executive Director	Achievement under the 2018 AIP	2018 AIP payment
Paul Geddes	68% of maximum	£982,569
Penny James	68% of maximum	£803,250
Mike Holliday-Williams	68% of maximum	£570,337
John Reizenstein	68% of maximum	£180,226

Note: The annual incentive award made to John Reizenstein represents a pro rated amount for the period to the AGM on 10 May 2018.

40% of any AIP award is deferred into shares under the DAIP, vesting three years after grant.

Financial element (55% weighting)

The financial performance measure is profit before tax. The Committee established a target performance level at the start of the year. The only adjustment from the reported accounting position, as explained in the letter from the Committee Chair, was to exclude the assumed benefit as a result of the Ogden discount rate change. In the table below, we have disclosed the target set for profit before tax performance. The actual profit before tax performance includes the adjustment to reported profit before tax as described above.

The approach taken to assessing financial performance against this measure was based on a straight-line outcome between 10% for threshold performance and 60% for on target performance, and a straight-line outcome between on target performance and 100% for achievement of maximum performance.

The formulaic outcome from 2018 performance against the financial measure was 64%, giving a total of 35% out of 55% attributable to this element. A summary of the assessment is provided in the following table.

Measure	Threshold 10%	Target 60%	Maximum 100%	2018 Actual	2018 Achievement
Profit before tax	£469.6m	£521.8m	£574.0m	£527.6m	64%

Customer element (15% weighting)

Customers are at the heart of the Group's strategy and success. As part of our customer strategy, and to ensure that the business strives to achieve a sustained and competitive level of overall service to our customers, the Board sets challenging customer-centric KPIs. These key customer metrics focus on continuous improvement of the customer experience. The Committee considered that overall the Group had continued to improve on an already strong performance against stretching targets. The Group's brands perform well (mainly top quartile) across the majority of insurance customer experience benchmarking studies.

Having considered performance against targets and an assessment of the quality of performance achieved, the Committee judged the Customer measures to be on target and agreed an out-turn of 60%, giving a total of 9% out of 15% attributable to this element. A detailed assessment of the Customer measures is set out below.

Measure	Assessment
Net Promoter Score (NPS) Improvement of customer advocacy across Direct Line Group	– Direct Line NPS was ahead of the target and continued to show strong year on year performance. Market leading propositions were successfully launched during the year and are performing well with consumers. – Churchill NPS was relatively flat over the year, and was below the target set for 2018; we launched campaigns focused on meeting key customer needs for target segments. – An improved perception of 'price' and 'value for money' supported the significantly increased Renewal NPS for the year during which several of our best ever months were recorded. – Rescue NPS performance ended the year below the target set as the result of a challenging H1 due to extreme weather events, with improved performance across H2.
Complaints Reduction in complaints volume and process improvements	– The volume of complaints in Personal Lines and Commercial reduced significantly in 2018, exceeding the stretch targets for both areas. – We introduced and rolled out a specialist bereavement team to assist the families of deceased customers. – Claims complaints were adverse to target due to higher than forecast volumes caused by extremes in weather in the first half of 2018, with performance stabilising throughout the second half of 2018.

Claims Ease
Increase ease on claims and strategic improvements
	– We were unable to meet the ambitious targets set in this area in a year when the 'Beast from the East' and increased volume challenged capacity across claims and networks.
	– However several programmes contributed to improvements for customers, including:
	  – earlier identification of total loss vehicles in Motor which resulted in faster payments, a key driver of improved Ease for customers.
	  – Travel 'Return to Green' plan (all KPIs at target levels) successfully delivered against a challenging landscape.

MyCustomer Transaction customer experience performance measuring our people/calls	– Over 1.5 million responses from customers across the Group have provided feedback on the experience delivered by our people and 84% rated our people as 9 or 10 out of 10. A new platform was launched in Q4 to further improve insight capabilities. – In Personal Lines MyCustomer consultant performance was significantly ahead of target. – MyCustomer for Claims stabilised in H2 after a challenging start to the year due to the high volumes of claims, however ended the year short of the ambitious target set.

Measure	2018 Achievement
Customer element	60%

People element (10% weighting)

For the People element of the AIP, the Board set a range of people measures specifically around succession strength, diversity and employee engagement, reflecting the importance of this agenda to the success of the Group. The Committee considered that performance across these measures was very strong and had exceeded expectations against a background of high employee engagement. The Committee therefore agreed an out-turn of 100% for the People measures, giving a total of 10% out of 10% attributable to this element. A detailed assessment of the People measures is set out below.

Measure	Assessment
Succession	– We continue to develop our senior leaders, collectively and as individuals, to ensure we continue to strengthen our succession depth. – After a comprehensive programme in 2017 to map our talent, with a particular focus on gender balance, we developed an emerging leader programme which has been attended by 20 high potential managers in 2018. – 52 (87%) of our senior leaders have completed personal assessments and profiles carried out to enable individual development planning in 2018 and development of the senior leadership team as a whole, and have attended mental health awareness training. – We have successfully recruited for our new graduate and apprenticeship schemes with a further 26 graduates and 114 apprentices joining us during 2018.
Diversity	– Since becoming a signatory to the Women in Finance Charter, we have actively recruited and promoted more women into senior roles; women now account for 28% of our senior management (2017: 22%) and we are on track to meet our 2019 target. – We continue to focus on building an inclusive organisation, valuing diversity and uniqueness. 93% of our people responded positively that they feel they can 'bring all of themselves to work' in our 2018 survey. – All senior leaders have Diversity and Inclusion action plans in place. – We launched Wellbeing, CSR and My Life family policies to respond to the variety of life needs our people may have. – Mental health was a particular focus this year and we trained over 135 Mental Health First Aiders with at least one available on every floor across all our locations, and all people managers attended mental health awareness training. It is our aspiration to enable conversations and support to be at the same level as they are for physical health.
Engagement	– We achieved record participation levels (90%) in our employee survey, DiaLoGue, and increased our already high overall engagement levels from 78% in 2017 to 81%, which places us in the upper quintile of high performing companies. – We achieved a strong 2* accreditation in the Sunday Times 'Best Big Companies to Work For' survey and are extremely proud to have been ranked in third place overall in our first year of entry. – In 2018 our focus on fair pay for all employees resulted in 'Fair Deal' being one of the most positively valued aspects by our people in the 'Best Companies to Work For' survey. – About 250 of our people managers completed Engage training focused on helping them develop more authentic relationships with their people. – Through Idea Lab, our employee suggestions scheme established in 2015, we have adopted c.90 ideas to improve customer service, the way we work or save cost. Cost saving ideas have delivered over £3.2 million in savings so far and employees have received over £130 thousand in recognition rewards.

Measure	2018 Achievement
People	100%

Personal element (20% weighting)

This element relates to an objective that is shared across the Executive Committee and set by the Remuneration Committee. The shared objective for 2018 focused on the Company's key technology transformation and the changes it is making to its IT infrastructure, as well as other areas of the general change agenda. There has been significant progress on the stability and performance of the broader technology landscape and with the management of overall change across the organisation. Taking performance against each Executive Director's individual performance objectives and the above challenges into account, and the material progress seen over the past two years, the Committee determined that the Executive Directors should each receive awards of 70% of the maximum available, giving a total of 14% out of 20% attributable to this element. Further details of the assessment of the Personal element is set out below.

- We have remained focused on improving our digital offering, customer experience and operational efficiency, recognising the challenges experienced in previous years. The Committee is pleased to report that strong progress has been made in the development and delivery of the Group's ambitious technology transformation programme to build capability for the future. The implementation of the new core Personal Lines systems is on track to start to roll out for Motor and Travel during 2019, and within the budget as agreed with the Board. The programme includes a new pricing engine and a digital Travel platform, both of which went into testing in 2018.
- Following the launch of our bespoke Direct Line for Business insurance products, Hair & Beauty and Bed & Breakfast, Direct Line for Business launched Office, Professional and Retail. Although a few weeks later than scheduled, this release is the largest of our bespoke offerings to date, and supported by a national Small and Medium-sized Enterprises marketing campaign, has shown month on month improvements in gross written premiums in H2.
- Significant improvements in the stability and performance of the technology transformation programme, supporting our people perform their roles more efficiently, resulted in increased internal customer satisfaction, with savings for the programme on track.
- The Company saw satisfactory progress in implementing and embedding Change controls across the business.
- The EU General Data Protection Regulation programme was implemented successfully and notably delivered our compliance strategy ahead of time against tight deadlines.

Measure	2018 Achievement
Personal element	70%

LTIP outcomes for 2018 (Audited)

LTIP awards are granted in March and August of each year. Each grant is subject to the following performance conditions:

- RoTE (60% weighting) – performance is measured over three financial years starting from the 1 January preceding the March grant; and
- Relative TSR (40% weighting) – performance is measured over a three-year period from the date of grant.

2015 LTIP awards (vested in 2018)

Awards under the LTIP granted in March and August 2015 vested during 2018. They were subject to relative TSR performance over the three-year vesting period, and RoTE performance in 2015, 2016 and 2017.

Consistent with the regulations, the expected RoTE vesting outcomes for the year ended 31 December 2017 (together with the TSR elements from the 2014 awards), were included in the 2017 single remuneration figure in the 2017 report. The 2017 single remuneration figure has been updated in the 2018 report to reflect the known share price at the actual vesting date for the RoTE portion of the awards. You can find details of this on page 95. The performance outcomes of these elements are included in the table below.

The 2018 single remuneration figure includes the value of the 2015 TSR elements (which vested in March and August 2018). Details of the targets and performance achieved are set out in the table below.

The Committee was satisfied that the financial and risk underpins were met at the end of the vesting period and therefore the performance achieved against the targets and the vesting of the awards is as follows:

Award	Performance measure	Weighting	Threshold	Maximum	Actual performance	Achievement	Outcome
March 2015	Relative TSR (2018 single figure)	40%	Median	Upper quintile	Between median and upper quintile	62%	24.8%
	RoTE (2017 single figure)	60%	14.5%	17.5%	18.1%	100%	60%
	Total						84.8%
August 2015	Relative TSR (2018 single figure)	40%	Median	Upper quintile	Below median	0%	0%
	RoTE (2017 single figure)	60%	14.5%	17.5%	18.1%	100%	60%
	Total						60%

2016 LTIP awards (vesting in 2019)

Awards under the LTIP granted in March and August 2016 will vest during 2019. They are subject to relative TSR performance over the three-year vesting period, and RoTE performance in 2016, 2017 and 2018. The RoTE performance period for these awards ended on 31 December 2018 and performance in respect of this element is set out in the table below. Performance under the relative TSR measure will be assessed at the end of the vesting periods in March 2019 and August 2019 respectively and will be disclosed in the 2019 Directors' Remuneration Report. This is subject to the Committee's satisfaction that the financial and risk underpins have been met at the end of the vesting period.

Consistent with the regulations, the expected RoTE vesting outcomes (together with the TSR elements from the 2015 awards) are included in the 2018 single remuneration figures for the Executive Directors based on the three-month average share price to 31 December 2018. You can find details of this on page 95.

Award	Performance measure	Weighting	Threshold	Maximum	Actual performance	Achievement	Outcome
March 2016	Relative TSR (2019 single figure)	40%	Median	Upper quintile	Performance period not yet complete		
	RoTE (2018 single figure)	60%	14.5%	17.5%	18.5%	100%	60%
August 2016	Relative TSR (2019 single figure)	40%	Median	Upper quintile	Performance period not yet complete		
	RoTE (2018 single figure)	60%	14.5%	17.5%	18.5%	100%	100%

Summary of the 2018 LTIP single remuneration figure outcomes

		Number of shares awarded (inc. dividends) subject to this performance condition	Percentage vested by reference to performance achieved	Number of shares vested	Total value of shares (inc. dividends) vested £'000
March 2016 LTIP – RoTE[1]	Paul Geddes	149,080	100%	149,080	£477
	Mike Holliday-Williams	75,723	100%	75,723	£242
	John Reizenstein	90,233	100%	73,504	£235[2]
August 2016 LTIP – RoTE[1]	Paul Geddes	149,743	100%	149,743	£479
	Mike Holliday-Williams	76,054	100%	76,054	£243
	John Reizenstein	90,626	100%	61,079	£195[2]
March 2015 LTIP – TSR	Paul Geddes	106,371	62%	65,929	£247
	Mike Holliday-Williams	55,110	62%	34,157	£128
	John Reizenstein	64,383	62%	39,904	£150
August 2015 LTIP – TSR	Paul Geddes	111,350	0%	0	£0
	Mike Holliday-Williams	56,558	0%	0	£0
	John Reizenstein	67,396	0%	0	£0
Total single figure LTIP	Paul Geddes				£1,204
	Mike Holliday-Williams				£614
	John Reizenstein				£150[2]

Notes:
1. 2016 RoTE elements are based on the three-month average share price to 31 December 2018 of £3.20042.
2. John Reizenstein stepped down from the Board on 10 May 2018. His 2016 LTIP awards are pro rated accordingly and will be disclosed as a payment to past directors in the 2019 annual report on remuneration. John Reizenstein's 2018 single figure disclosure will therefore only include the amount vesting in relation to the March 2015 TSR component of the LTIP.

Buy-out award

The second tranche of Penny James' buy-out award is due to vest on 1 April 2019, based on the achievement of performance targets that relate partly to the performance of the Company and partly to the performance of her previous employer. The performance conditions for this award are relative TSR (50%) and IFRS profit over 2016, 2017 and 2018 (50%). Relative TSR performance is measured against a peer group based on the prior employer's TSR performance from 1 January 2016 to 31 October 2017 and Direct Line Group's TSR performance from 1 November 2017 to 31 December 2018 with a threshold vesting of median (25% vests) and a maximum vesting of upper quartile (100% vests). The peer group is consistent with that used by the prior employer.

Relative TSR performance over the period was just below the upper quartile of the comparator group. As such, 94.7% of this element will vest. The prior employer does not disclose the IFRS profit targets in advance of vesting. The outcome for this element is estimated to be 100% based on the prior employer's previous year's LTIP out-turn and the 2018 mid-year results. The overall estimated vesting outcome is therefore 97% of maximum. The final vesting outcome will be disclosed in the 2019 Directors' Remuneration Report once the prior employer's targets and actual performance have been published. The number of shares expected to vest is 705,871, calculated as 97% of 725,199. The estimated value is £2,259,087 based on a three-month average share price to 31 December 2018 of £3.20042.

Using shares (Audited)

In receiving an award under the LTIP or DAIP, Executive Directors commit not to hedge their exposure to outstanding awards under these plans or in respect of shares they are reporting to the Company within their ownership for the purposes of any share ownership guidelines. They also agree not to pledge as collateral their participation under any of the plans or any shares which they are required to hold in the Company for any purposes, including for share ownership guidelines.

	At 31 December 2018			
	Share plan awards subject to performance conditions	Share plan awards subject to continued service	Share plan interests vested but unexercised	Shares held outright
Paul Geddes	1,081,288	320,239	1,154	759,844
Penny James	1,413,501	106,242	–	213,075
Mike Holliday-Williams	829,306	193,524	–	372,026

Note:
There have been no changes to the above share interests since 31 December 2018.

	Share plan interests exercised during the year to 31 December 2018	
	Number of options exercised	Share price on date of exercise
Paul Geddes	365,467	3.7280
	167,025	3.3200
Penny James	145,500	3.3520
Mike Holliday-Williams	200,807	3.7280
	84,837	3.3200

Note:
The above relates to nil cost options.

	At end of employment 7 September 2018			
	Share plan awards subject to performance conditions	Share plan awards not subject to performance conditions	Share plan interests vested but unexercised	Shares held outright
John Reizenstein	659,353	169,104	1,052,440	511,489

	Share plan interests exercised during the year to end of employment 7 September 2018	
	Number of options exercised	Share price on date of exercise
John Reizenstein	208,988	3.7280
	971,146	3.3710
	101,094	3.3200

Note:
The above relates to nil cost options.

The table below shows the Non-Executive Directors' beneficial interests in the Company's shares.

Director	Shares held at 31 December 2018	Shares held at 31 December 2017
Michael Biggs	–	–
Danuta Gray	10,000	10,000
Mark Gregory[3]	–	n/a
Jane Hanson	11,083	26,190
Sebastian James	5,000	5,000
Fiona McBain[4]	–	n/a
Andrew Palmer[5]	10,475	10,475
Gregor Stewart[6]	–	n/a
Clare Thompson	44,065	40,128
Richard Ward	–	–

Notes:
1. There were no changes to the number of shares held by Non-Executive Directors between the year end and the date of this report.
2. Includes holdings of connected person, as defined in section 96B(2) of the Financial Services and Markets Act 2000.
3. Mark Gregory was appointed to the Board with effect from 1 March 2018.
4. Fiona McBain was appointed the Board with effect from 1 September 2018.
5. Andrew Palmer stepped down from the Board at the AGM on 10 May 2018 and this represents his holding at that date.
6. Gregor Stewart was appointed to the Board with effect from 1 March 2018.

Non-Executive Directors (Audited)

Fees were the only remuneration paid to Non-Executive Directors in 2017 and 2018. Non-Executive Directors may also claim for reasonable travel and subsistence expenses, in accordance with the Group's travel and expenses policy, and, where these are classified as taxable by HMRC, they are shown under 'Taxable Benefits' below. The Non-Executive Directors receive no other benefits.

	Fees		Taxable Benefits[2]		Total	
Director[1]	2018 £'000	2017 £'000	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Michael Biggs	400	400	6	6	406	406
Danuta Gray[3]	103	74	4	–	107	74
Mark Gregory[4]	75	–	–	–	75	–
Jane Hanson	120	115	10	12	130	127
Sebastian James	95	90	–	–	95	90
Fiona McBain[5]	25	–	2	–	27	–
Andrew Palmer[6]	51	125	–	–	51	125
Gregor Stewart[7]	88	–	4	–	92	–
Clare Thompson	102	110	–	–	102	110
Richard Ward	120	115	0.4	–	120.4	115

Notes:
1. Non-Executive Directors are not eligible to participate in any of the Group's bonus or share incentive schemes or to join any Group pension scheme.
2. The values shown under 'Taxable Benefits' above comprise the value of taxable travel and subsistence expenses reimbursed by the Company (including any gross-up for tax and National Insurance Contributions due).
3. Danuta Gray was appointed as Chair of the Remuneration Committee with effect from the AGM on 10 May 2018.
4. Mark Gregory was appointed to the Board with effect from 1 March 2018. He was appointed as Chair of the Investment Committee and as a member of the Audit Committee with effect from the AGM on 10 May 2018.
5. Fiona McBain was appointed to the Board with effect from 1 September 2018.
6. Andrew Palmer stepped down from the Board at the AGM on 10 May 2018.
7. Gregor Stewart was appointed to the Board with effect from 1 March 2018. He was appointed as Chair of the Audit Committee and as a member of the Board Risk Committee with effect from the AGM on 10 May 2018.

CEO pay ratio

The Committee has chosen to adopt early the CEO pay ratio disclosure requirements which would otherwise come into effect from next year's Directors' Remuneration Report. Over the coming year, the Committee will determine the appropriate methodology (Option A, B or C) to be used in future years, considering the robustness of the calculation methodology, the consistency of the method going forward as well as operational time constraints. For the purposes of this year's disclosure, the April 2018 gender pay gap data has been used to identify the three appropriate employees for comparison with the CEO (Option B). Further detail on this methodology is set out below.

The table below compares the 2018 single total figure of remuneration for the CEO with that of the Group employees who are paid at the 25th percentile (lower quartile), 50th percentile (median) and 75th percentile (upper quartile) of its employee population.

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2018	Option B	127:1	116:1	81:1

The remuneration figures for the employee at each quartile were determined with reference to 31 December 2018.

Under Option B, the latest available gender pay gap data is used to identify the best equivalent for three Group employees whose hourly rates of pay are at the 25th, 50th and 75th percentiles for the Group and their total pay and benefits figure for 2018 is then calculated. A sample of employees with hourly pay rates either side of the initially identified individuals are also reviewed to ensure that the appropriate representative employees are selected. The table below sets out the salary and total pay and benefits for the three identified quartile point employees:

	25th percentile (P25)	Median (P50)	75th percentile (P75)
Salary	£20,072	£24,810	£34,452
Total pay and benefits	£25,072	£27,538	£39,555

Each employee's pay and benefits were calculated using each element of employee remuneration, consistent with the CEO, on a full-time equivalent basis. No adjustments (other than to achieve full-time equivalent rates) were made and no components of pay have been omitted.

Base salaries of all employees, including our Executive Directors, are set with reference to a range of factors including market practice, experience and performance in role. For reference, the CEO base salary median pay ratio is 33:1. In reviewing the ratios the Committee also noted that the CEO's remuneration package is weighted more heavily towards variable pay (including the AIP and LTIP) than the wider workforce due to the nature of the role, and this means the ratio is likely to fluctuate depending on the performance of the business and associated outcomes of incentive plans in each year.

The Group's employees are fundamental to the Group's strategy and to ensuring a high level of service to our customers. We are proud that the high number of consultants in our customer service centres are employed by the Group (rather than being outsourced), and note that the impact of these lower paid roles is reflected in the ratios above. Further details on our approach to fairly paying and motivating our employees are set out on page 58.

Percentage change in Chief Executive Officer's pay for 2017 to 2018

The table below shows the Chief Executive Officer's year on year percentage change in salary, taxable benefits and bonus, compared to the average pay for all other employees.

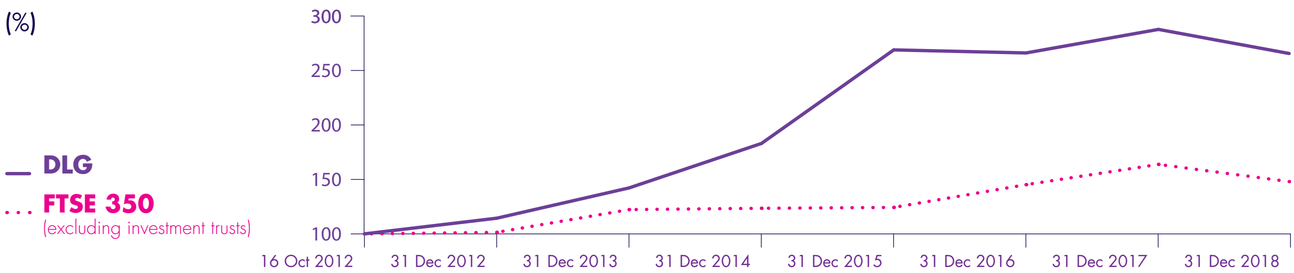
	Salary[1]	Benefits[2]	Bonus (including deferred amount)[3]
Chief Executive Officer	2.5%	7.1%	(20.9%)
All employees (average)	4.46%	16.9%	(12.1%)

Notes:
1. Based on the change in average pay for employees employed in the year ended 31 December 2018 and the year ended 31 December 2017.
2. There were no changes in benefits provision between 2017 and 2018. There has been a change in the assumptions used to calculate the all-employee average benefits figure, making the year on year change appear high to last year. If the treatment was the same as previous years, this would result in a 5% benefits increase from 2017 for all employees.
3. For employees other than the Chief Executive Officer, this includes average amounts earned under the AIP, and other variable incentive schemes, including monthly and quarterly incentive schemes operated in certain parts of the Group.

Chief Executive Officer's pay between 2012 and 2018 and historical performance of TSR

The table below shows historical levels of the Chief Executive Officer's pay between 2012 and 2018. It also shows vesting of annual and long-term incentive pay awards as a percentage of the maximum available opportunity. This is presented against the Company's TSR since its shares began trading on the London Stock Exchange in October 2012, against the FTSE 350 Index (excluding investment trusts) over the same period. This peer group is the same used for measuring relative TSR under the LTIP.

Total Shareholder Return



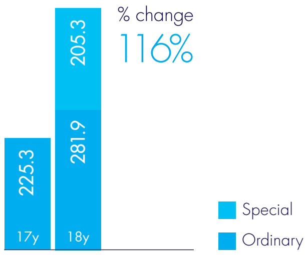
	2012	2013	2014	2015	2016[2]	2017[3]	2018[4]
CEO single figure of remuneration (£'000s)	1,908	2,536	5,356	4,795	4,348	4,039	3,238
Annual bonus payment (% of maximum)	65%	63%	75%	83%	63%	88%	68%
LTIP vesting (% of maximum)[1]	30%	55%	88%	96%	86%	99%	71%

Notes:
1. Based on actual vesting under the 2010, 2011 and 2012 RBS Group LTIP. The value included in the single figures in respect of these awards is £205,000 in 2012, £728,000 in 2013 and £2,437,428 in 2014.
2. The 2016 single figure and annual bonus payment have been updated to reflect an adjustment to the original award of 20% of maximum opportunity related to the Ogden discount rate change.
3. The 2017 single figure has been revised to reflect the actual vesting of the 2015 awards under the LTIP, an increase of £292,700.
4. The 2018 single figure reflects the estimated vesting of the RoTE portion of the LTIP granted in March and August 2016. Any shares under the LTIP granted in 2015 will not be delivered until the end of the applicable vesting periods in March and August 2019. However, they have been included in the single figure, as the performance period in respect of the RoTE portion has now been completed.

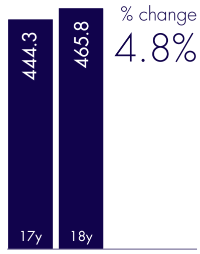
Distribution statement

This chart shows the overall pay expenditure across all Group employees compared with the total dividend value paid to shareholders in 2017 and 2018.

Dividend (£m)



Overall expenditure on pay (£m)



Notes:
1. During 2018 the Company paid special dividends of £205m in addition to the regular dividends. Under the dividend policy the Board considers whether to make additional distributions each year alongside the full-year results. During 2017, no special dividend was paid for the 2016 financial year as following the implementation of the new Ogden discount rate the Board did not consider the Group had surplus capital.
2. There have been no share buy-backs since the IPO. The dividends paid information has been taken from note 14 to the consolidated financial statements. The overall expenditure on pay has been taken from note 10 and therefore, consistent with market practice, it has not been calculated in a manner consistent with the single figure in this report.

AGM voting outcomes

The table shows the percentage of shareholders voting for or against, and the percentage of votes withheld, relating to the resolutions to approve the 2017 Directors' Remuneration Report which was put to shareholders at the 2018 AGM on 10 May 2018.

The resolution approving the Directors' Remuneration Report was passed by 76.58% of the votes cast in favour of the resolution. The reasons for this outcome and subsequent actions taken are discussed by the Chair in her letter on page 90.

	For		Against		Number of votes withheld (abstentions)	Percentage of votes withheld (abstentions)
	Number	Percentage	Number	Percentage		
Approval of Directors' Remuneration Report (2018 AGM)	766,710,834	76.58%	234,492,835	23.42%	7,284,313	0.72%
Approval of Directors' Remuneration Policy (2017 AGM)	881,046,703	98.29%	15,349,348	1.71%	32,669,059	3.52%

Shareholdings (Audited)

This table sets out the share ownership guidelines and actual share ownership levels:

Name	Position	Share ownership guideline[1] (% of salary)	Value of shares held at 31 December 2018 (% of salary)
Paul Geddes	Chief Executive Officer	200%	292%
Penny James	Chief Financial Officer	200%	101%
Mike Holliday-Williams	MD Personal Lines	200%	211%

Notes:
1. Executive Directors are expected to retain all the 'after tax' Ordinary Shares they obtain from any of the Company's share incentive plans until they achieve a shareholding level that is equal to 200% of base salary.
2. For these purposes, holdings of Ordinary Shares will be treated as including all vested but unexercised awards, or awards unvested but after the performance period in the holding period, valued on a basis that is net of applicable personal taxes payable on acquiring such Ordinary Shares.

Direct Line Group share awards

Direct Line Group Deferred Annual Incentive Plan awards (Audited)

This table details the Directors' interests under the Direct Line Group DAIP.

Grant date	Three-day average share price for grant of awards £	Face value of award £	No. of share options as at 1 January 2018	No. of share options granted during the year[1]	No. of share options vested during the year	No. of dividend shares acquired at vesting[2]	No. of dividend shares added post vesting	No. of share options exercised[1,3,4,5]	No. of share options held at 31 December 2018[6]	Vesting date
Paul Geddes										
28-Mar-13	2.0157	380,004	1,044	–	–	–	110	–	1,154	28-Mar-16
25-Mar-15	3.3007	400,000	111,087	–	111,087	28,874	–	139,961	–	25-Mar-18
29-Mar-16	3.752	447,996	119,402	–	–	–	–	–	119,402	29-Mar-19
27-Mar-17	3.36	237,715	70,713	–	–	–	–	–	70,713	27-Mar-20
26-Mar-18	3.818	496,816	–	130,124	–	–	–	–	130,124	26-Mar-21
			302,246	**130,124**	**111,087**	**28,874**	**110**	**139,961**	**321,393**	
Penny James										
26-Mar-18	3.818	405,636	–	106,242	–	–	–	–	106,242	26-Mar-21
			–	**106,242**	**–**	**–**	**–**	**–**	**106,242**	
Mike Holliday-Williams										
25-Mar-15	3.3007	239,997	66,651	–	66,651	17,324	–	83,975	–	25-Mar-18
29-Mar-16	3.752	270,797	72,174	–	–	–	–	–	72,174	29-Mar-19
27-Mar-17	3.36	154,030	45,819	–	–	–	–	–	45,819	27-Mar-20
26-Mar-18	3.818	288,378	–	75,531	–	–	–	–	75,531	26-Mar-21
			184,644	**75,531**	**66,651**	**17,324**	**–**	**83,975**	**193,524**	
John Reizenstein										
28-Mar-13	2.0157	137,999	94,009	–	–	–	9,911	–	103,920	28-Mar-16
25-Mar-15	3.3007	207,200	57,542	–	57,542	14,957	–	72,499	–	25-Mar-18
29-Mar-16	3.752	240,800	64,179	–	–	–	–	–	64,179	29-Mar-19
27-Mar-17	3.36	123,318	36,683	–	–	–	–	–	36,683	27-Mar-20
26-Mar-18	3.818	257,724	–	67,502	–	–	–	–	67,502	26-Mar-21
			252,413	**67,502**	**57,542**	**14,957**	**9,911**	**72,499**	**272,284**	

Notes:
1. These awards take the form of nil-cost options over the Company's shares. Awards granted before 2014 accrue dividend entitlements until the date of transfer of shares. Awards granted from 2014 accrue dividend entitlement from the grant date to the date on which an award vests.
2. Dividends added post-vesting are shown to 31 December 2018, although these are not realised until exercise.
3. Paul Geddes exercised 139,961 options on 26 March 2018 when the share price was £3.728 resulting in a notional gain of £521,775.
4. Mike Holliday-Williams exercised 83,975 options on 26 March 2018 when the share price was £3.728 resulting in a notional gain of £313,059.
5. John Reizenstein exercised 72,499 options on 26 March 2018 when the share price was £3.728 resulting in a notional gain of £270,276.
6. John Reizenstein stepped down from the Board at the AGM on 10 May 2018 and his share interests are as that date. However, the movements in his DAIP interests across the entire year are disclosed above. Further information on what happened to his share scheme interests on leaving employment (on 7 September 2018) can be found on page 108.
7. The dates of the three-day averaging period used to determine the number of shares granted on 26 March 2018 were 21, 22 and 23 March, being the three days preceding the grant.

Direct Line Group Long-Term Incentive Plan awards (Audited)

This table details the Directors' interests in the Company's LTIP. For all LTIP awards, 20% of the awards granted would vest if the minimum performance was achieved.

Grant date	Three- day average share price for grant of awards £	Face value of award £	No. of share options at 1 January 2018[1]	No. of share options granted during the year[2]	No. of share options vested during the year[3]	No. of share options lapsed for performance [4]	No. of share options lapsed on leaving employment	No. of dividend shares acquired at vesting [5]	No. of dividend shares added post vesting	No. of share options exercised [6]	No. of share options held at 31 December 2018	Vesting date
Paul Geddes												
25-Mar-15	3.3007	760,000	211,066	–	178,984	32,082	–	46,522	–	225,506	–	25-Mar-18
26-Aug-15	3.517	775,200	220,415	–	132,249	88,166	–	34,776	–	167,025	–	26-Aug-18
29-Mar-16	3.752	775,197	206,609	–	–	–	–	–	–	–	206,609	29-Mar-19
30-Aug-16	3.6833	794,598	215,730	–	–	–	–	–	–	–	215,730	30-Aug-19
27-Mar-17	3.361667	794,597	236,370	–	–	–	–	–	–	–	236,370	27-Mar-20
29-Aug-17	3.854	810,488	210,298	–	–	–	–	–	–	–	210,298	29-Aug-20
26-Mar-18	3.818	810,492	–	212,281	–	–	–	–	–	–	212,281	26-Mar-21
			1,300,488	**212,281**	**311,233**	**120,248**	**–**	**81,298**	**–**	**392,531**	**1,081,288**	
Penny James												
28-Nov-17	3.5673	1,349,984	378,433	-	–	–	–	–	–	–	378,433	28-Nov-20
26-Mar-18	3.818	675,000	-	176,794	–	–	–	–	–	–	176,794	26-Mar-21
28-Aug-18	3.3377	675,000	-	202,237	–	–	–	–	–	–	202,237	28-Aug-21
			378,433	**379,031**	**–**	**–**	**–**	**–**	**–**	**–**	**757,464**	

Notes:
The Company's share price on 31 December 2018 was £3.187, and the range of prices in the year was £3.049 to £3.932.

1. These awards take the form of nil-cost options over the Company's shares and are subject to performance conditions to be assessed by the Committee. Awards granted before 2014 accrue dividend entitlements until the date of transfer of shares. Awards granted from 2014 accrue dividend entitlement from the grant date to the date on which an award vests.
2. The RoTE targets for awards granted in 2018, applying to 60% of the award, were 17.5% for 20% vesting,18.5% for 40% vesting and 20.5% for full vesting. A straight-line interpolation occurs from threshold to target, and then from target to maximum performance. The remaining 40% of each award is based on TSR performance conditions, which are the same as noted on page 111.
3. The closing market price on the dates of the vesting of the awards was £3.728 on 26 March 2018 and £3.371 on 28 August 2018.
4. Awards under the LTIP vested at 84.8% of the maximum potential on 26 March 2018 and 60.0% of the maximum potential on 28 August 2018.
5. Dividends added post-vesting are shown to 31 December 2018, although these are not realised until exercise.
6. Paul Geddes exercised 225,506 options on 26 March 2018 when the share price was £3.728 resulting in a notional gain of £840,686, and on 29 August 2018 167,025 options when the share price was £3.32 resulting in a notional gain of £554,523.
7. The dates of the three-day averaging period used to determine the number of shares granted on 26 March 2018 were 21, 22 and 23 March, being the three days preceding the grant. The dates of the three-day averaging period used to determine the number of shares granted on 28 August were 22, 23 and 24 August.
8. The performance period for the awards granted on 26 March 2018 will end on 31 December 2020 for the RoTE element and 25 March 2021 for the TSR element. The performance period for the awards granted on 28 August 2018 will end on 31 December 2020 for the RoTE element and 27 August 2021 for the TSR element.

All awards made from August 2017 include an additional two-year holding period before awards may be released. The Company's normal policy is to grant awards twice a year, after the Group announces its full and half-year results. The value of each grant of awards is set at 50% of the annual policy level. This means the total combined face value of awards per year to each of the Executive Directors equates to 200% of base salary.

Direct Line Group Long-Term Incentive Plan awards (Audited) continued

Grant date	Three-day average share price for grant of awards £	Face value of award £	No. of share options at 1 January 2018[1]	No. of share options granted during the year[2]	No. of share options vested during the year[3]	No. of share options lapsed for performance [4]	No. of share options lapsed on leaving employment	No. of dividend shares acquired at vesting [5]	No. of dividend shares added post vesting	No. of share options exercised [6,7]	No. of share options held at 31 December 2018[8]	Vesting date
Mike Holliday-Williams												
25-Mar-15	3.3007	393,747	109,351	–	92,729	16,622	–	24,103	–	116,832	–	25-Mar-18
26-Aug-15	3.5170	393,749	111,956	–	67,173	44,783	–	17,664	–	84,837	–	26-Aug-18
29-Mar-16	3.7520	393,750	104,944	–	–	–	–	–	–	–	104,944	29-Mar-19
30-Aug-16	3.6833	403,572	109,568	–	–	–	–	–	–	–	109,568	30-Aug-19
27-Mar-17	3.361667	538,099	160,069	–	–	–	–	–	–	–	160,069	27-Mar-20
29-Aug-17	3.854	548,860	142,413	–	–	–	–	–	–	–	142,413	29-Aug-20
26-Mar-18	3.818	548,862	–	143,756	–	–	–	–	–	–	143,756	26-Mar-21
28-Aug-18	3.3377	562,584	–	168,556	–	–	–	–	–	–	168,556	28-Aug-21
			738,301	312,312	159,902	61,405	–	41,767	–	201,669	829,306	
John Reizenstein												
7-Nov-12	1.96	460,000	299,271	–	–	–	–	–	31,551	330,822	–	9-Nov-15
28-Mar-13	2.0157	459,999	302,089	–	–	–	–	–	31,848	333,937	–	28-Mar-16
28-Aug-13	2.1564	459,999	277,167	–	–	–	–	–	29,220	306,387	–	28-Aug-16
25-Mar-15	3.3007	460,000	127,750	–	108,332	19,418	–	28,157	–	136,489	–	25-Mar-18
26-Aug-15	3.5170	469,200	133,409	–	80,045	53,364	–	21,049	–	101,094	–	26-Aug-18
29-Mar-16	3.7520	469,199	125,053	–	–	–	23,184	–	–	–	101,869	29-Mar-19
30-Aug-16	3.6833	480,899	130,562	–	–	–	42,567	–	–	–	87,995	30-Aug-19
27-Mar-17	3.361667	480,900	143,054	–	–	–	74,006	–	–	–	69,048	27-Mar-20
29-Aug-17	3.854	490,518	127,275	–	–	–	83,844	–	–	–	43,431	29-Aug-20
			1,665,630	–	188,377	72,782	223,601	49,206	92,619	1,208,729	302,343	

Notes:
The Company's share price on 31 December 2018 was £3.187, and the range of prices in the year was £3.049 to £3.932.

1. These awards take the form of nil-cost options over the Company's shares and are subject to performance conditions to be assessed by the Committee. Awards granted before 2014 accrue dividend entitlements until the date of transfer of shares. Awards granted from 2014 accrue dividend entitlement from the grant date to the date on which an award vests.
2. The RoTE targets for awards granted in 2018, applying to 60% of the award, were 17.5% for 20% vesting, 18.5% for 40% vesting and 20.5% for full vesting. A straight-line interpolation occurs from threshold to target, and then from target to maximum performance. The remaining 40% of each award is based on TSR performance conditions, which are the same as noted on page 111.
3. The closing market price on the dates of the vesting of the awards was £3.728 on 26 March 2018 and £3.371 on 28 August 2018.
4. Awards under the LTIP vested at 84.8% of the maximum potential on 26 March 2018 and 60.0% of the maximum potential on 28 August 2018.
5. Dividends added post-vesting are shown to 31 December 2018, although these are not realised until exercise.
6. Mike Holliday-Williams exercised 116,832 options on 26 March 2018 when the share price was £3.728 resulting in a notional gain of £435,550 and 84,837 options on 29 August 2018 when the share price was £3.32 resulting in a notional gain of £273,175.
7. John Reizenstein exercised 136,489 options on 26 March 2018 when the share price was £3.728 resulting in a notional gain of £508,831, 971,146 options on 28 August 2018 when the share price was £3.371 resulting in a notional gain of £3,273,733 and 101,094 options on 29 August 2018 when the share price was £3.32 resulting in a notional gain of £335,632.
8. John Reizenstein stepped down from the Board at the AGM on 10 May 2018 and his share interests are as at that date. However, the movements in his LTIP interests across the entire year are disclosed above. Further information on what happened to his share scheme interests on leaving employment (on 7 September 2018) can be found on page 106.
9. The dates of the three-day averaging period used to determine the number of shares granted on 26 March 2018 were 21, 22 and 23 March, being the three days preceding the grant. The dates of the three-day averaging period used to determine the number of shares granted on 28 August were 22, 23 and 24 August.
10. The performance period for the awards granted on 26 March 2018 will end on 31 December 2020 for the RoTE element and 25 March 2021 for the TSR element. The performance period for the awards granted on 28 August 2018 will end on 31 December 2020 for the RoTE element and 27 August 2021 for the TSR element.

All awards made from August 2017 include an additional two-year holding period before awards may be released. The Company's normal policy is to grant awards twice a year, after the Group announces its full and half-year results. The value of each grant of awards is set at 50% of the annual policy level. This means the total combined face value of awards to each of the Executive Directors equates to 200% of base salary.

Buy-out awards (Audited)

The table below details buy-out awards made to Penny James. These awards were made to the CFO in November 2017 as compensation for the forfeiture of legacy awards granted by her previous employer. The awards were made in the form of restricted stock options (pursuant to Listing Rule 9.4.2) and subject to performance conditions that, as far as possible, mirrored those of the original awards.

The first tranche of these buy-out awards, which vested in April 2018, was subject to the performance conditions and comparator groups identical to those of the original award, ending in the 2017 performance year. For the second tranche, which will vest in April 2019, the performance conditions differ from the above in that the Group's TSR performance replaces that of the former employer for the period from 1 November to 31 December 2018 (post-joining).

The awards accrue dividend equivalent shares until vesting, as per the terms of the legacy awards.

Grant date	Three-day average share price for grant of awards £	Face value of award £	No. of share options at 1 January 2018	No. of share options vested during the year	No. of share options lapsed for performance	No. of dividend shares acquired at vesting	No. of share options exercised	No. of share options held at 31-Dec-18	Vesting date
Penny James									
28-Nov-17	3.5673	500,492	140,298	134,454	5,844	11,046	145,500	–	3-Apr-18
Penny James									
28-Nov-17	3.5673	2,340,304	656,037	–	–	–	–	656,037	1-Apr-19

Notes:
1. Penny James exercised 145,500 options on 2 August 2018 when the share price was £3.352 resulting in a notional gain of £487,716.
2. The first tranche of the above buy-out awards vested on 2 May 2018, deferred from the original vesting date of 3 April 2018 due to the Company being in a closed period from 29 March to 1 May 2018.

Direct Line Group 2012 Share Incentive Plan (Audited)

During 2018, all employees, including Executive Directors, were eligible to invest from £10 to £150 a month from their pre-tax pay into the scheme, and receive one matching share for every two shares they purchased. This table details the number of shares held by John Reizenstein under the SIP. Paul Geddes, Mike Holliday-Williams and Penny James do not participate in the plan.

Director	Matching shares as at 31 December 2017	Matching shares granted during the period	Matching shares cancelled during the period	Matching shares vested during the period	Value of matching shares granted[1] £	Balance of matching shares at 10 May 2018
John Reizenstein	742	80	–	82	303	740

Notes:
1. The accumulated market value of matching shares at the time of each award. Purchase of the matching shares takes place within 30 days of the contributions being deducted from salary.
2. John Reizenstein stepped down from the Board on 10 May 2018 and his interests are shown as at that date. On leaving employment on 7 September 2018, his SIP shares were transferred to him in accordance with the rules of the scheme.

Dilution

The Company complies with the dilution levels that the Investment Association guidelines recommend. These levels are 10% in 10 years for all share plans and 5% in 10 years for discretionary plans. This is consistent with the rules of the Company's share plans.

Statement of policy implementation in 2019

Executive Directors' salaries in 2019

The salary increase awarded to the Executive Directors, effective 1 April 2019, reflects the average increase awarded to staff generally.

Director	Position	2019 base salary £'000	2018 base salary £'000	Annual change in base salary
Paul Geddes	Chief Executive Officer to 9 May 2019	831	831	–
Penny James	Chief Financial Officer to 9 May 2019	675	675	–
	CEO-designate from 9 May 2019	800	–	–
Mike Holliday-Williams	MD Personal Lines	575	563	2.25%

AIP 2019

Director	Position	Maximum annual incentive award for 2019 (% base salary)	Deferred under the DAIP (% bonus)
Paul Geddes	Chief Executive Officer	175%	40%
Penny James	CEO-designate	175%	40%
Mike Holliday-Williams	MD Personal Lines	150%	40%

The AIP measures remain unchanged:

	Measures	Weighting for 2019	Weighting for 2018
Financial	Profit before tax	55%	55%
Customer	A range of customer metrics including Net Promoter Score and complaints	15%	15%
People	A range of people measures including succession, diversity and engagement	10%	10%
Personal	Objectives for each Executive Director, including shared objectives across the Executive Committee	20%	20%

As in previous years, all AIP outcomes will be determined after the Committee establishes a payment gateway. To do this, the Committee must be satisfied that it is appropriate to permit a bonus award at all, or at a given level. The gateway involves some subjectivity about performance. This may result in positive or negative moderation of each AIP performance measure or the overall bonus outcome. The targets are commercially sensitive and will be disclosed in next year's report.

The list on the following page sets out the gateway criteria for the AIP for 2019.

Gateway criteria for the AIP for 2019 – outcomes for Executive Directors

- Year on year changes in profit before tax
- Quality and sustainability of earnings, referring to reserving, gross written premium, costs and loss ratio, and relevant lead indicators
- Additional customer context, for example, conduct, experience, brand and franchise health
- Capital strength and affordability
- Risk management within risk appetite
- The Group's relative performance to that of its peers
- The wider economic environment
- Exceptional events, such as abnormal weather
- Any regulatory breaches and/or reputational damage to the Group
- Committee satisfaction that paying the bonus does not cause major reputational concerns

The Committee may also use its discretion to account for additional factors. These include the quality of financial results, the 'direction of travel' of all measures, and, more widely, reputation, risk and audit.

In considering such factors, and whether to adjust the overall pay-outs and/or operate malus and clawback, the Committee receives appropriate input from the Audit Committee and the Board Risk Committee.

LTIP 2019

Director	Position	Annual LTIP award for 2019
Paul Geddes	Chief Executive Officer	–
Penny James	CEO-designate	200%
Mike Holliday-Williams	MD Personal Lines	200%

Performance conditions for LTIP awards

LTIP awards to be granted in 2019 will continue to be subject to performance against these performance conditions:

- 60% based on RoTE over a three-year performance period (2019, 2020 and 2021)
- 40% based on relative TSR performance against the constituents of the FTSE 350 (excluding investment trusts) over a three-year performance period, starting on the date of grant. The starting and closing TSR will be averaged over a three-month period.

For these purposes, we use the Group's standard definition for RoTE, subject to such other adjustments as the Committee may consider appropriate. To find out more about how we calculate RoTE, see page 192.

The Committee reviewed the performance targets and decided to maintain the RoTE target range at the same level as in 2018 as follows:

Performance measure	Vesting for threshold performance	Performance required for threshold vesting			Performance required for maximum vesting		
		Awards in 2019	Awards in 2018	Awards in 2017	Awards in 2019	Awards in 2018	Awards in 2017
RoTE	20% of this element of the award	Average annual RoTE performance of 17.5%	Average annual RoTE performance of 17.5%	Average annual RoTE performance of 15.0%	Average annual RoTE performance of 20.5%	Average annual RoTE performance of 20.5%	Average annual RoTE performance of 18.0%
Relative TSR	20% of this element of the award		Median			Upper quintile	

For the TSR element, there is a straight-line interpolation between threshold and maximum performance on a ranked basis.

For the RoTE element, 20% of the award will vest for threshold RoTE and 40% for a RoTE of 18.5% for awards to be made in 2019. Otherwise, vesting is similar to TSR: a straight-line interpolation occurs from threshold to target, then from target to maximum performance.

The LTIP awards will also vest only to the extent that the Committee is satisfied that the outcome of the TSR and RoTE performance conditions reflects the Group's underlying financial performance from the date of grant until vesting. When considering these matters, the Committee will also consider whether there have been any material risk failings.

The LTIP will continue to be subject to the application of malus and clawback and an additional two-year holding period post vesting which facilitates post-employment shareholding requirements. The Committee will be considering the application of a post-employment shareholding requirement in more detail as part of the Remuneration Policy review during 2019.

Pension and benefits

A pension contribution of 25% of base salary will be paid to the CEO in 2019 (until date of leaving). The pension contribution for the CEO-designate will be reduced from the current level of 25% of salary to 9% of salary (from date of appointment) in line with the wider workforce. A pension contribution of 15% of salary will be paid to the MD Personal Lines in 2019; this level of contribution remained unchanged following his promotion to the Board in 2017. Pension contribution rates will be in line with those of the wider workforce for all new Executive appointments. The reduction in pension contributions for the current Executive Directors, in line with those of the wider workforce, will be considered as part of the policy review during 2019. No Directors participate in any defined benefit pension arrangements operated by the Company.

Appointment of new Chief Executive Officer

On 26 February 2019, Penny James, the current CFO, was appointed CEO-designate to succeed Paul Geddes. Penny will become CEO from the conclusion of the AGM on 9 May 2019. Penny's annual salary will be £800,000. This salary is in line with the FTSE 51-100 CEO benchmark and below the current CEO's salary level.

At the same time, Penny's pension contribution will be reduced from her current contribution rate of 25% of salary to 9% of salary, in line with that of the wider workforce. There will be no change to her participation in the Company's AIP up to a maximum of 175% of salary and the LTIP up to 200% of salary.

Retirement of Executive Director (Audited)

John Reizenstein, the former CFO, retired on 7 September 2018 having stepped down from the Board as an Executive Director at the end of the AGM on 10 May 2018. Following his cessation as a Director of the Company, John's salary, pension and benefits were paid in monthly instalments until the end of his employment as follows:

Pay component	Salary (£'000)	Pension (£'000)	Benefits (£'000)	Total (£'000)
Payments since cessation as a Director of the Company	160	40	3	203

John's planned retirement was announced in September 2017 and the Committee confirmed his 'good leaver' status, without the exercise of any discretion, at that time. He has, therefore, retained share awards granted to him up to that date (for details of all awards see pages 106 and 108). LTIP awards made in 2016 and 2017 have been time pro rated to reflect the period from their date of grant to the end of his period of employment. No LTIP awards were made to him in 2018. John has also been made an award under the AIP for the period to the AGM on 10 May 2018, details of which can be found on page 96.

Payments to former Directors (Audited)

There have been no payments made to a former Director during the year, with the exception of the payments made to John Reizenstein since his cessation as a Director of the Company.

Non-Executive Directors' fees

Position	Fees for 2019 £'000
Board Chairman fee	400
Basic Non-Executive Director fee	75
Additional fees	
Senior Independent Director fee	30
Chair of Audit, Board Risk and Remuneration Committees	30
Chair of CSR and Investment Committees	10
Member of Board Committee (Audit, Board Risk or Remuneration)	10
Member of Board Committee (CSR or Nomination)	5

No additional fees are paid for membership of the Investment Committee.

External directorships

Paul Geddes is a Non-Executive Director for Channel 4 for which he receives and retains an annual fee of £22,177. Otherwise, the Executive Directors do not currently hold any further external directorships.

Service contracts

Subject to the discretion set out in the recruitment remuneration policy, it is the Company's policy to set notice periods for Executive Directors of no more than 12 months (both by the Director or Company). The Executive Directors' service agreements summary is as follows:

Director	Effective date of contract	Notice period (by Director or Company)	Exit payment policy
Paul Geddes	1 September 2012	12 months	Base salary only for unexpired portion of notice period to be paid in a lump sum or monthly instalments, in which case, instalments are subject to mitigation if an alternative role is found.
Mike Holliday-Williams	30 January 2014		
Penny James	1 November 2017		

There are no further obligations which could give rise to a remuneration or loss of office payment other than those set out in the remuneration policy and the termination policy.

The Chairman and Non-Executive Directors have notice periods of three months from either party which do not apply in the case of a Director not being re-elected by shareholders or retiring from office under the Articles of Association. Other than fees for this notice period, the Chairman and Non-Executive Directors are not entitled to any compensation on exit.

The Board reviewed and approved this report on 4 March 2019.

DANUTA GRAY
CHAIR OF THE REMUNERATION COMMITTEE

Policy report

The following is a copy of the main table from the policy approved by shareholders at the 2017 AGM. The full policy is available in the Directors' Remuneration Report of the 2016 Annual Report and Accounts.

Policy table

Element	Purpose and link to strategy	Operation

Base salary	– This is the core element of pay that reflects the individual's role and position within the Group. It is payable for doing the expected day-to-day job
	– Staying competitive in the market allows us to attract, retain and motivate high-calibre executives with the skills to achieve our key aims while managing costs
		– Base salaries are typically reviewed annually and set in April of each year, although the Committee may undertake an out-of-cycle review if it determines this to be appropriate
		– When reviewing base salaries, the Committee typically takes the following into account:
		  – level of skill, experience and scope of responsibilities, individual and business performance, economic climate, and market conditions;
		  – the median market pay in the context of companies of a similar size, particularly FTSE 31-100 companies, as they are considered to reflect the size and complexity of the Group;
		  – the practice of insurance peers such as Admiral Group, Aviva, esure Group, Hastings Group, Legal & General, Old Mutual, Phoenix Group, Prudential, RSA Insurance Group, Standard Life and companies of a similar size to DLG as appropriate; and
		  – general base salary movements across the Group
		– The Committee does not follow market data strictly. However, it uses it as a reference point in considering, in its judgement, the appropriate salary level, while regarding other relevant factors, including corporate and individual performance, and any changes in an individual's role and responsibilities
		– The principles for setting base salary are similar to those applied to other employees in the Group. However, the specific benchmarking groups used to review external market relativities may differ across employee groups
		– Base salary is typically paid monthly

Pension	– To remain competitive within the market place – To encourage retirement planning and retain flexibility for individuals	– Pension contributions are paid only in respect of base salary – Executive Directors are eligible to participate in the defined contribution pension arrangement or alternatively they may choose to receive a cash allowance in lieu of pension
Benefits	– A comprehensive and flexible benefits package is offered, emphasising individuals being able to choose the combination of cash and benefits that suits them	– Executive Directors receive a benefits package generally set by reference to market practice in companies of a similar size and complexity, particularly FTSE 31-100 companies. Benefits currently provided include a company car or car allowance, private medical insurance, life insurance, health screening and income protection – The Committee may periodically amend the benefits available to some or all employees. The Executive Directors are eligible to receive such additional benefits as the Committee considers appropriate having regard to market norms – In line with our approach to all employees, certain Group products are offered to Executive Directors at a discount – Executive Directors are eligible to participate in any of the employee share plans operated by the Company, in line with HMRC guidelines (where relevant) and on the same basis as other eligible employees. Currently, this includes the Share Incentive Plan ("SIP"), which has been used to provide an award of free shares to all employees (including Executive Directors), and permit employees to purchase shares with a corresponding matching award – Where an Executive Director is required to relocate to perform their role, they may be offered appropriate relocation benefits. The level of such benefits would be determined based on the circumstances of the individual and typical market practice

Maximum opportunity	Performance measures
– When determining salary increases, the Committee will consider the factors outlined in this table under 'Operation'. In any event, no increase will be made if it would take an Executive Director's salary above £850,000 (the current median level of salaries for CEOs in the FTSE 100), as further increased by UK RPI from the date of approving this policy	– Not applicable
– The maximum pension contribution is set at 25% of base salary per annum	– Not performance-related
– The costs of benefits provided may fluctuate from year to year, even if the level of provision has remained unchanged. An annual limit of 10% of base salary per Executive Director has been set for the duration of this policy (plus an additional amount of up to 100% of salary in respect of relocation expenses). The Committee will monitor the costs in practice and ensure the overall costs do not increase by more than the Committee considers to be appropriate in all the circumstances – Additionally, the limit for any employee share plans in which the Executive Directors participate will be in line with the caps permitted by HMRC from time to time – The Executive Directors may be entitled to retain fees received for any directorships held outside the Group – Similarly, while not benefits in the normal usage of that term, certain other items such as hospitality or retirement gifts may also be provided	– Not performance-related

Element	Purpose and link to strategy	Operation
AIP	– To motivate executives and incentivise delivery of performance over a one-year operating cycle, focusing on the short- to medium-term elements of our strategic aims	– For Executive Directors, at least 40% of the award is deferred into shares under the Deferred Annual Incentive Plan (the "DAIP"). This typically vests three years after grant (with deferred awards also capable of being settled in cash at the discretion of the Committee, for example, when it gives rise to legal difficulties to settle in shares). The remainder of the award is paid in cash following the year end – The Committee will keep the percentage deferred and terms of deferral under review. This will ensure levels are in line with regulatory requirements and best practice and may be changed in future years but will not, in the Committee's view, be changed to be less onerous overall – Malus and clawback provisions apply to the cash and deferred elements. These are explained in the notes to the policy table
LTIP	– Aligning executives' interests with those of shareholders to motivate and incentivise delivering sustained business performance over the long term – To aid retaining key executive talent long-term	– Awards will typically be made in the form of nil-cost options or conditional share awards, which vest to the extent performance conditions are satisfied over a period of at least three years. Under the Plan rules, awards may also be settled in cash at the discretion of the Committee. This may be appropriate, for example, if legal difficulties arise with settling in shares – Vested options will remain exercisable up to the 10th anniversary of grant – Malus and clawback provisions apply to the LTIP. These are explained in the notes to the policy table – Awards under the LTIP may be made at various times during the financial year. While the Committee reserves the right to do otherwise, the Committee's practice has been to make awards twice in each financial year, following the announcement of the Group's annual and half-year results – For awards made after adopting the new policy at the 2017 AGM, Executive Directors will be subject to an additional two-year holding period following the three-year vesting period, during which time awards may not normally be exercised or released. During the additional holding period the awards will continue to accrue dividends. Following the holding period awards will cease to accrue dividends if not exercised
Share ownership guidelines	– To align the interests of Executive Directors with those of shareholders	– Executive Directors are expected to retain all the Ordinary Shares vesting under any of the Company's share incentive plans, after any disposals for paying applicable taxes, until they have achieved the required shareholding level unless such earlier sale, in exceptional circumstances, is permitted by the Chairman

Maximum opportunity	Performance measures
– Maximum and target bonus levels for Executive Directors are set by taking into account annual bonus practice throughout the organisation and referring to practice at other insurance and general market comparators – The maximum bonus opportunity under the AIP is 175% of base salary per annum. The current maximum bonus opportunity applying for each individual Executive Director is shown in the statement of implementation of policy	– Performance over the financial year is assessed against performance measures which the Committee considers to be appropriate – These may be financial, non-financial (Group, divisional or business line) and individual. Each year, at least 50% of the bonus is based on financial measures. The remainder of the bonus may be based on a combination of strategic, shared and individual performance measures – The Committee sets targets at the beginning of each financial year – No more than 10% of the bonus is paid for threshold performance (30% of the bonus for the individual performance element). No more than 60% of the maximum opportunity pays out for target performance. However, the Committee retains flexibility to amend the pay-out level at different levels of performance for future bonus cycles. This is based on its assessment of the level of stretch inherent in the set targets, and the Committee will disclose any such determinations appropriately – Before any payment can be made, the Committee will perform an additional gateway assessment (including in respect of any risk concerns). This will determine whether the amount of any bonus is appropriate in view of facts or circumstances which the Committee considers relevant. This assessment may result in moderating (positively or negatively) each AIP performance measure, subject to the individual maximum bonus levels – The AIP remains a discretionary arrangement. The Committee reserves discretion to adjust the out-turn (from zero to the cap), should it consider it appropriate
– The maximum LTIP award in normal circumstances is 200% of salary – Awards of up to 300% of base salary are permitted in exceptional circumstances, relating to recruiting or retaining an employee, as determined by the Committee	– The Committee will determine the performance conditions for each award made under the LTIP, measuring performance over a period of at least three years with no provision to retest – Performance is measured against targets set at the beginning of the performance period, which may be set by referring to the time of grant or financial year – Awards vest based on performance against financial and/or such other (including share return) measures, as set by the Committee, to be aligned with the Group's long-term strategic objectives – For awards to be granted in 2017, vesting will continue to be determined based on two measures: RoTE and relative TSR performance against the FTSE 350 (excluding investment trusts). The Committee may apply different performance measures and targets for future awards, provided not less than 50% of the award shall be subject to one or more financial measures, and not less than 25% shall be subject to a relative TSR measure – Awards will be subject to a payment gateway, such that the Committee must be satisfied that there are no material risk failings, reputational concerns or regulatory issues – Additionally, there is a financial underpin relating to the Committee's view of the Group's underlying financial performance for the TSR and RoTE (and any other) elements; 20% of the award vests for threshold performance, with 100% vesting for maximum performance. The Committee reserves the right in respect of future awards to lengthen (but not reduce) any performance period and/or amend the terms of any holding period; however, there is no intention to reduce the length of the holding period
– 200% of salary for all Executive Directors – The Committee reserves the discretion to amend these levels in future years	– Not applicable

The Directors present their report for the financial year ended 31 December 2018.

You can find the forward-looking statements disclaimer on page 195.

Strategic report

The Company's Strategic report is on pages 1 to 59. It includes the following information that would otherwise need to be disclosed in this Directors' report:

Subject	Pages
Use of financial instruments	30 and 36
Important events since the financial year end	12 to 17
Likely future developments in the business	17
Employee involvement	56 to 59
Research and development	18 to 21

Corporate governance statement

The FCA's Disclosure Guidance and Transparency Rules require a corporate governance statement in the Directors' report to include certain information. You can find information that fulfils the corporate governance statement's requirements in this Directors' report; the Corporate Governance report; the Committee reports; and the Directors' remuneration report, on pages 60 to 117. This information is incorporated in the Directors' report by reference.

Disclosure of information under Listing Rule 9.8.4R

In accordance with Listing Rule 9.8.4C, the table below sets out the location of the information required to be disclosed, where applicable.

Subject	Page
Interest capitalised by the Group	None
Unaudited financial information	None
Long-term incentive plan involving one Director only	109
Directors' waivers of emoluments	109
Directors' waivers of future emoluments	Not applicable
Non pro-rata allotments for cash (issuer)	Not applicable
Non pro-rata allotments for cash (major subsidiaries)	None
Listed company is a subsidiary of another company	Not applicable
Contracts of significance involving a director	Not applicable
Contracts of significance involving a controlling shareholder	Not applicable
Details of shareholder dividend waivers	119
Controlling shareholder agreements	Not applicable

Dividends

The Board recommends a final dividend of 14.0 pence per share to shareholders. Subject to shareholder approval at the Company's 2019 AGM, this will become payable on 16 May 2019 to all holders of Ordinary Shares on the Register of members at close of business on 5 April 2019. A special interim dividend has been declared of 8.3 pence per share and will have the same record and payment dates as the final dividend for 2018.

The final dividend resolution provides that the Board may cancel the dividend and, therefore, payment of the dividend at any time before payment, if it considers it necessary to do so for regulatory capital purposes. You can find detailed explanations about this in the Notice of AGM 2019. Likewise, the special interim dividend can also be cancelled if necessary.

You can find further details regarding dividends paid during 2017 and 2018 in the Finance review on page 26 and in note 14 to the consolidated financial statements on page 164. You can also find information on dividend and capital management in the Finance review on page 32.

Directors

You can find the current Directors' biographies on pages 62 to 64. All Directors will retire and, excepting Paul Geddes and Clare Thompson, will be submitted for election or re-election at the 2019 AGM. This is in accordance with the UK Corporate Governance Code and the Articles of Association of the Company, which govern appointing and replacing Directors.

The Directors listed on pages 62 and 64 were the Directors of the Company throughout the year apart from Mark Gregory and Gregor Stewart, who were each appointed as Directors on 1 March 2018, and Fiona McBain, who was appointed as a Director on 1 September 2018; Andrew Palmer and John Reizenstein also served during the year, retiring from the Board on 10 May 2018.

The Company's Articles of Association set out the Directors' powers. You can view these on the Company's website at www.directlinegroup.co.uk. The Directors' powers are also subject to relevant legislation and, in certain circumstances, authority from the Company's shareholders. You can find details of the Directors' remuneration, service contracts, employment contracts and interests in the shares of the Company in the Directors' remuneration report on pages 88 to 117.

The Articles of Association of the Company permit it to indemnify the Company's officers, and officers of any associated company, against liabilities arising from conducting Company business, to the extent permitted by law. As such, the Company has executed deeds of indemnity for each Director's benefit, regarding liabilities that may attach to them in their capacity as Directors of the Company or associated companies.

These indemnities are qualifying third-party indemnities as defined by section 234 of the Companies Act 2006. No amount was paid under any of these indemnities during the year. The Company maintains directors' and officers' liability insurance. This provides appropriate cover for legal actions brought against its Directors. The Company has also provided the directors of DLG Pension Trustee Limited with qualifying pension scheme indemnities. This is in accordance with section 235 of the Companies Act 2006. DLG Pension Trustee Limited acts as trustee for two of the Company's occupational pension schemes.

Secretary

Roger Clifton is the Company Secretary of Direct Line Insurance Group plc. He can be contacted at the Company's Registered Office, details of which are on page 196.

Share capital

The Company has a premium listing on the London Stock Exchange. As at 31 December 2018, the Company's share capital comprised 1,375,000,000 fully paid Ordinary Shares of 10 10/11 pence each.

At the Company's 2018 AGM, the Directors were authorised to:

- allot shares in the Company or grant rights to subscribe for, or convert any security into shares, up to an aggregate nominal amount of £50,000,000 and to allot further shares up to an aggregate nominal amount of £50,000,000, for the purpose of a rights issue;
- allot shares having a nominal amount not exceeding in aggregate £7,500,000 for cash, without offering the shares first to existing shareholders in proportion to their holdings;
- allot additional shares having a nominal amount not exceeding in aggregate £7,500,000 for the purposes of financing a transaction which the Board of the Company determines to be an acquisition or other capital investment, without offering the shares first to existing shareholders in proportion to their holdings;
- make market purchases of up to 137,500,000 shares in the Company, representing 10% of the Company's issued share capital at the time; and
- allot shares (with the disapplication of pre-emption rights) up to an aggregate nominal amount of £23,250,000 in relation to the issue of solvency II RT1 Instruments.

To date, the Directors have not used these authorities. At the 2019 AGM, shareholders will be asked to renew these authorities. The Company has not held any shares in treasury during the period under review. You can find out more about the Company's share capital and shares under option at as 31 December 2018 in notes 29 and 35 to the consolidated financial statements.

Under the Company's Share Incentive Plan, Trustees hold shares on behalf of employee participants. The Trustees will only vote on those shares and receive dividends that a participant beneficially owns, in accordance with the participant's wishes. An Employee Benefit Trust also operates. The Trustee of this has discretion to vote on any shares it holds as it sees fit, except any shares participants own beneficially; in which case, the Trustee will only vote on such shares as per a participant's instructions.

The Trustee of the Employee Benefit Trust has waived its right to dividends on all shares within the Trust. You can find out more about the number of shares held by the employee share plan trusts in note 35 on page 176. The Company is only aware of the dividend waivers and voting restrictions mentioned above.

Shareholder voting rights and restrictions on transfer of shares

All the Company's issued Ordinary Shares rank equally in all respects. The Company's Articles of Association set out the rights and obligations attaching to the Company's Ordinary Shares.

Employees of the Company and Directors must conform with the EU Market Abuse Regulation and the Company's share dealing rules. These rules restrict particular employees' and Directors' ability to deal in the Company's shares at certain times, and require the employee or Director to obtain permission to deal before doing so. Some of the Company's employee share plans also include restrictions on transferring shares while the shares are held within the plans.

Each general meeting notice will specify the time for determining a shareholder's entitlement to attend and vote at the meeting. This will not be more than 48 hours before the time fixed for the meeting (which may exclude non-working days). To be valid, all proxy appointments must be filed at least 48 hours before the time of the general meeting. In calculating this time period, no account shall be taken of any part of a day that is not a working day.

Where the Company has issued a notice under section 793 of the Companies Act 2006, which is in default for at least 14 days, the person(s) interested in those shares shall not be entitled to attend or vote at any general meeting until the default has been corrected or the shares sold.

There is no arrangement or understanding with any shareholder, customer or supplier, or any other external party, which provides the right to appoint a Director or a member of the Executive Committee, or any other special rights regarding control of the Company.

Articles of Association

Unless expressly specified to the contrary in the Articles of Association, they may only be amended by a special resolution of the Company's shareholders at a general meeting.

Significant agreements affected by a change of control

A number of agreements may take effect, alter or terminate upon a change of control of the Company. None of these agreements is considered significant in terms of its impact on the Group's business as a whole. All the Company's employee share incentive plans contain provisions relating to a change of control. Outstanding awards would typically vest and become exercisable. This is subject to satisfying any performance conditions, and normally with an additional time-based pro-rata reduction where performance conditions apply, and approval from the Remuneration Committee.

Substantial shareholdings

In accordance with the provisions of chapter 5 of the FCA's Disclosure Guidance and Transparency Rules, the Company has been notified of the following direct and indirect interests in the Company's voting rights. Information provided by the Company pursuant to the FCA's Disclosure Guidance and Transparency Rules is publicly available via the regulatory information services and on the Company's website.

	31 December 2018	4 March 2019
APG Asset Management N.V	3.35%	3.26%
Artemis Investment Management LLP	4.79%	4.81%
BlackRock, Inc.	10.13%	10.14%
Standard Life Aberdeen plc	8.08%	8.32%
T.Rowe Price Associates, Inc	5.79%	4.52%

Political donations

The Group made no political donations during the year (2017: nil).

Employees with disabilities

The Group is committed to promoting diversity and inclusion across every area of the business through initiatives such as the DNA. At recruitment, we adjust and enhance our application and selection process, and guide and provide additional training for interviewers, where necessary.

Our DNA focuses on a number of strands including employees with disabilities. It identifies areas where we can improve and help people to continue working for us. We reasonably adjust employees' working environments and equipment, and roles and role requirements. We also ensure that everyone can access the same opportunities.

Greenhouse gas emissions

In order to comply with the Companies Act 2006 (Strategic and Directors' Report) Regulations 2013, the Group has followed the 2013 UK Government environmental reporting guidance for GHG emissions; used the UK Government's greenhouse gas conversion factors; and adopted the financial control approach to setting the organisational boundaries of responsibilities for GHG emissions. In applying the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) we have calculated emissions associated with electricity consumption using both the location-based Scope 2 and market-based Scope 2 calculation methodologies. GHG emissions are classified as direct or indirect, and divided into Scope 1, Scope 2 and Scope 3 emissions. Direct GHG emissions are those from sources that the Group owns or controls. Indirect GHG emissions are those that are a consequence of the Group's activities, but occur at sources owned or controlled by another organisation. The Group has considered the seven main GHGs, reported in tonnes of carbon dioxide equivalent ("**CO_2e**"), and set 2013 as the base year.

Scope 1 – direct emissions including fuels used in office buildings, accident repair centres and owned vehicles.

Scope 2 – indirect emissions resulting from generating electricity purchased for office buildings and accident repair centres.

Scope 3 – includes all other indirect emissions such as waste disposal, business travel and staff commuting.

Total GHG emissions (Scope 1 and Scope 2) in 2018 were 16,219 tonnes (2017: 17399 tonnes), as set out in the table below. This primarily comprised emissions from purchased electricity and natural gas, diesel fuel, and refrigerant gas used. In addition to total emissions, the Group also monitors emissions per £ million of net earned premium. In 2018, this was 5.2 tonnes CO_2e per £ million of net earned premium (2017: 5.5 tonnes). This is a measure of how efficiently insurance products are provided. It allows us to compare our year-on-year performance and performance against other insurance companies. You can find verification statements on the Group's website at www.directlinegroup.co.uk. You can find further information on the Group's approach to energy and the environment in the Responsibility report on page 55.

Global GHG emissions data for reporting year 1 January 2018 – 31 December 2018

Emissions from:	Scope 2 Location-based Tonnes of CO_2e	Scope 2 Market-based Tonnes of CO_2e
Combustion of fuel & operation of facilities (Scope 1)	8,304	8,304
Electricity, heat, steam and cooling purchased for own use (Scope 2)	7,915	10,290
Total (Scope 1 & 2)	16,219	18,594
Intensity metric: tonnes CO_2e/ Million GBP net earned premium (£m)	5.2	6.0
Transmission and Distribution ("T&D") losses from electricity (Scope 3)	675	675
Total (Scope 1, 2 & 3 – T&D Losses)	16,894	19,269
Intensity metric: tonnes CO_2e/ Million GBP net earned premium (£m)	5.5	6.2
T&D losses from electricity, commuting, paper and business travel (Scope 3)	17,809	17,809
Total (Scope 1, 2 & 3)	34,028	36,403
Intensity metric: tonnes CO_2e/ Million GBP net earned premium (£m)	11.0	11.8

Year on year comparison (Scope 2 location-based methodology)

	Tonnes of CO_2e			
Emissions from:	2013	2017	2018	Percentage change (2013 to 2018)
Scope 1	8,429	8,027	**8,304**	-1.5
Scope 2	21,480	9,371	**7,915**	-63.2
Total (Scope 1 & 2)	29,909	17,399	**16,219**	-45.8
Intensity metric: tonnes CO_2e/million GBP net earned premium (£m)	8.5	5.5	**5.2**	-38.2
Scope 3 (Only T&D losses from electricity)	1,774	876	**675**	-62.0
Total (Scope 1, 2 & 3 – T&D losses)	31,683	18,275	**16,894**	-46.7
Intensity metric: tonnes CO_2e/Million GBP net earned premium (£m)	9.0	5.8	**5.5**	-39.2

Going concern

The Group has sufficient financial resources to meet its financial needs, including managing a mature portfolio of insurance risk. The Directors believe the Group is well positioned to manage its business risks successfully in the current economic environment.

The Finance review on pages 32 to 34 describes the Group's capital management strategy, which covers how it measures its regulatory and economic capital needs and deploys capital.

The Group's financial position is also covered in that section, including a commentary on cash and investment levels, reserves, currency management, insurance liability management, liquidity and borrowings. Additionally, note 3 to the consolidated financial statements describes capital management needs and policies. The note also covers insurance, market, liquidity and credit risks which may affect the Group's financial position.

Having made due enquiries, the Directors reasonably expect that the Company and the Group have adequate resources to continue in operational existence for at least 12 months from 4 March 2019 (the date of approval of the financial statements). Accordingly, the Directors have adopted the going concern basis in preparing the financial statements.

Disclosing information to the Auditor

Each Director at the date of approving these Annual Report & Accounts confirms that: as far as they are aware, there is no relevant audit information of which Deloitte, the Company's External Auditor, is unaware; and they have taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information, and to establish that Deloitte is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

Deloitte has expressed its willingness to continue in office as the External Auditor. A resolution to reappoint Deloitte will be proposed at the forthcoming AGM. You can find an assessment of the effectiveness and recommendation for reappointing Deloitte in the Audit Committee report on page 79.

Directors' responsibility statement

The Directors are responsible for preparing the Annual Report and financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare such financial statements for each financial year. Under that law, the Directors must prepare the Group financial statements in accordance with IFRS, as adopted by the EU and Article 4 of the International Accounting Standard ("**IAS**") regulation. The Directors have also chosen to prepare the Parent Company financial statements under IFRS, as adopted by the EU. Under company law, the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the Company's state of affairs and profit or loss for that period.

In preparing these financial statements, IAS 1 requires that Directors: properly select and apply accounting policies; present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and assess the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that: are sufficient to show and explain the Company's transactions and disclose, with reasonable accuracy, the Company's financial position at any time; and enable them to ensure the financial statements comply with the Companies Act 2006. Additionally, the Directors are responsible for safeguarding the Company's assets and, hence, taking reasonable steps to prevent and detect fraud and other irregularities. The Directors are responsible for maintaining and ensuring the integrity of the corporate and financial information included on the Company's website at www.directlinegroup.co.uk. Legislation in the UK governing preparing and disseminating financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed on pages 62 to 64, confirms that, to the best of their knowledge:

- the financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position, and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic report (on pages 1 to 59) and Directors' report (on pages 118 to 121) include a fair review of:
  (i) the business's development and performance; and
  (ii) the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face; and
- the Annual Report and the financial statements, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

The Board reviewed and approved this report on 4 March 2019.

By order of the Board

ROGER C. CLIFTON
COMPANY SECRETARY

CONTENTS

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements of Direct Line Insurance Group plc (the "**Parent Company**") and its subsidiaries (together the "**Group**") give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("**IFRSs**") as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board ("**IASB**");
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 "Reduced Disclosure Framework" applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the Consolidated Income Statement;
- the Consolidated and Parent Company Statements of Comprehensive Income;
- the Consolidated and Parent Company Balance Sheets;
- the Consolidated and Parent Company Statements of Changes in Equity;
- the Consolidated Cash Flow Statement; and
- the related notes 1 to 41 on the Consolidated financial statements and related notes 1 to 17 on the Parent Company financial statements, excluding the capital adequacy disclosures in note 3 calculated in accordance with the Solvency II regime which are marked as unaudited.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's ("**FRC**") Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that no non-audit services prohibited by the FRC's Ethical Standard were provided to the Group or the Parent Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: – valuation of insurance reserves: 1) The frequency and severity of bodily injury claims; and 2) The inflation and discount rate assumptions for valuing periodic payment orders ("**PPOs**"). – valuation of intangible assets; and – valuation of investments not held at fair value. These key audit matters are consistent with those identified in the prior period audit.
Materiality	The materiality that we used for the Group financial statements was £28 million which approximates 5.2% of three-year average profit before tax.
Scoping	Our Group audit scoping included two entities being subject to a full scope audit and a further two entities being subject to an audit of specified account balances. These four entities represent the principal business units and account for 99% of the Group's net assets, 100% of the Group's gross earned premium and 98% of the Group's profit before tax.
Significant changes in our approach	There have been no significant changes in our approach.

Conclusions relating to going concern, principal risk and viability statements

Going concern

We have reviewed the Directors' statement on page 121 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Parent Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

We considered as part of our risk assessment the nature of the Group, its business model and related risks including where relevant the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the Directors' assessment of the Group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the Directors' plans for future actions in relation to their going concern assessment.

Principal risks and viability statement

Based solely on reading the Directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the Directors' assessment of the Group's and Parent Company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 46 and 47 that describe the principal risks and explain how they are being managed or mitigated;
- the Directors' confirmation on page 75 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the Directors' explanation on page 49 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

We are also required to report whether the Directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon. We do not provide a separate opinion on these matters.

Valuation of insurance reserves

Refer to page 77 (Audit Committee Report), page 138 (Accounting policies) and page 174 (Financial statements).

The Group's insurance reserves total £4.0 billion (2017: £4.2 billion). The determination of the value of the insurance reserves requires significant judgement in the selection of key actuarial methodologies and assumptions. Small changes in these methodologies or assumptions can materially impact the valuation of these liabilities. We have identified the following two key areas of focus for our audit given their significance to the Group's result and the level of judgement involved. Therefore, we have also identified these as potential fraud risk areas.

1) The frequency and severity of large bodily injury claims

Key audit matter description

The insurance reserve valuation for large bodily injury claims has a significant impact on the Group's results, with the ultimate quantum of large bodily injury claims being driven by a variety of factors. These factors include the completeness and accuracy of source data, the transparency of any changes in the reporting of large claims, and actuarial assumptions being consistent with emerging data, internal processes and market factors. As a result of these factors, there is a significant level of estimation uncertainty in the valuation of these claims, which increases the susceptibility of the balance to material misstatement due to error and fraud.

Furthermore, a key market factor occurring in 2018 was the Civil Liability Act, which came into force on 20 December 2018 after passing Royal Assent. Going forward this Act will result in the Government determining the Ogden discount rate, which is currently minus 0.75%, with reference to 'low risk' rather than 'very low' or 'zero risk' investments. The Government will also now conduct regular rate reviews at least every five years. In response to this legislative change the Group has moved to valuing its lump sum bodily injury reserves using an Ogden discount rate of 0%, rather than minus 0.75%, on the basis that the Civil Liability Act requires the Government to set the discount rate with reference to low risk rather than very low risk investments. The selection of the new rate required significant judgement by management and has resulted in a reduction in the insurance reserves of £55 million.

How the scope of our audit responded to the key audit matter
We have gained a detailed understanding of the end-to-end claims and reserving process and assessed the design and implementation of selected controls, including peer review of actuarial workings and committees where the key assumptions are challenged. In order to gain assurance over the completeness and accuracy of source data used in the Group's actuarial calculations and by our in-house actuarial specialists in performing their work, we have tested the operating effectiveness of data reconciliations controls and performed reconciliations on the data back to the financial ledger.

Having done this, we worked with those specialists to:

– assess and challenge the methodologies and key assumptions, and their underlying rationale, adopted by the Group, including the potential risk of increased claims inflation caused by Brexit;
– review the estimated impact on reserves of recent paid and incurred claim developments using our in-house reserve software;
– inspect the Group's actuarial models and perform sensitivity testing and peer benchmarking on key assumptions;
– assess management's rationale for adopting a best estimate Ogden discount rate of 0%, and challenge its reasonableness in light of market benchmarking; and
– assess and challenge the methodology of the Group's Ogden sensitivity model.

Key *observations*
We have determined the estimate for the ultimate value of large bodily injury claims to be reasonable. In making this determination we observed that the frequency and severity assumptions used in determining the ultimate value are reasonable, albeit slightly prudent.

2) The inflation and discount rate assumptions for valuing PPOs

Key audit matter description
The Group is required to settle a proportion of large bodily injury claims as PPOs rather than lump sum payments. The valuation of PPOs has a material impact on the financial statements, with these liabilities totalling £875.9 million (2017: £898.7 million) on a discounted gross basis as detailed in note 2. PPOs are sensitive to the choice of inflation and discount rate used, with small rate changes resulting in material valuation differences. The significant judgement exercised by management in setting the inflation rate of 4% (2017: 4%) and discount rate of 4% (2017: 4%), increases the susceptibility of the balance to material misstatement due to error and fraud.

How the scope of our audit responded to the key audit matter
We have gained a detailed understanding over Management's process for setting these assumptions and assessed the design and implementation of key governance controls surrounding the setting of the PPO inflation rate and discount rate. In addition, we tested the operating effectiveness of a direct and precise business control, performed weekly, over the completeness of the PPO listing; this is a key data input which has a material impact on the PPO assumptions and hence the valuation.

We have worked with our actuarial specialists to:

– review and challenge the Group's PPO inflation assumption through inquiries with the Actuarial Director, reviewing relevant supporting documentation and benchmarking against market economic data, including the potential risk of increased claims inflation caused by Brexit;
– review the Group's sensitivity testing on the PPO inflation assumption;
– review and challenge the selected discount rate with reference to current and future performance of the assets backing the PPO liabilities, taking account of the uncertainty created for investment markets by Brexit; and
– challenge the consistency of the approach with that used in the 2017 year-end valuation and the appropriateness of maintaining that approach in light of the current economic climate and market benchmarking.

Key observations
We have determined that the inflation and discount rate assumptions used in the calculation of the PPO claims reserve are in the middle of a reasonable range. Given the current low yield environment, and the potential for increased risk of claims inflation in certain Brexit scenarios, we determined that these assumptions continue to require close monitoring going forward.

Valuation of intangible assets

Refer to page 77 (Audit Committee Report), page 138 (Accounting policies) and page 166 (Financial statements).

Key audit matter description

We have identified a key audit matter over the valuation of intangible assets totalling £354.1 million (2017: £258.8 million) as detailed in note 17. Our key audit matter specifically addresses those intangible assets relating to strategic projects that aim to improve the customer experience, support growth and increase efficiency across the Group.

Having decided to rework certain elements of the capitalised expenditure, which resulted in an impairment charge of £56.9 million in 2017, the Group has progressed in developing the asset with roll out scheduled to commence in 2019. Whilst this reduces the risk of delivery failure, in comparison to last year's audit, until the assets are complete there continues to be a risk of future impairment charges, with the determination of which requiring a significant level of judgement. As a result of these factors, we continue to identify this as a key audit matter as well as a potential fraud risk.

How the scope of our audit responded to the key audit matter

We assessed the design and implementation of key controls over the impairment of intangible assets. This included senior management review and approval of the impairment review.

In addition, we performed the following audit procedures:

- inquired of system integrators and programme managers, and inspected internal reports, system architecture maps and meeting minutes in order to challenge management on which components of the capital expenditure will ultimately be used in the end-state system;
- engaged our in-house IT consultants to assess the feasibility of the IT architecture in delivering the expected benefits across the Group; and
- challenged management on the reasonableness of the future cash flows for the assets. Whilst performing our work we leveraged our knowledge of the system based on our testing over the components of the capital expenditure.

Key observations

We have determined that the £nil impairment charge is reasonable. Based on the information available to date we deem the feasibility of successful project delivery and the expected benefits thereof to be reasonable.

Valuation of investments not held at fair value

Refer to page 77 (Audit Committee Report), page 139 (Accounting policies) and page 171 (Financial statements).

Key audit matter description

Investments that are not held at fair value are carried at amortised cost and represent a higher credit risk relative to the majority of DLG's investment portfolio. Our work primarily focused on the valuation of the Group's commercial real estate loan, infrastructure debt and private placement bond portfolios. Having recognised a £6 million (2017: £10 million) impairment on a non-performing loan in the year, these investments totalled £592.2 million (2017: £589 million) and represented 12.5% (2017: 11.7%) of the Group's investment portfolio.

The Group satisfies the exemption criteria within IFRS 4 Insurance Contracts and has decided to defer the application of IFRS 9 Financial Instruments until the expected effective date of the new insurance contracts standard IFRS 17 on 1 January 2022. Under IAS 39 Financial Instruments: Recognition and Measurement, management judgement continues to be required in determining if an incurred loss event has occurred and there is significant uncertainty in determining the fair value of the loans in the instance an event has occurred. As a result, we identified the valuation of investments not held at fair value as a key audit matter.

How the scope of our audit responded to the key audit matter

We have assessed the design and implementation and tested the operating effectiveness of the key controls that mitigate the risk over the valuation of investments not held at fair value. Our work included attendance at the year-end impairment review meeting in order to observe the operation of a key management review control.

In addition, we performed the following audit procedures:

- traced a sample of interest payments to bank during the year to test for default or delinquency in interest payments;
- engaged our in-house complex pricing team to determine an independent fair value of these assets and identify any significant decreases in fair value below book cost;
- assessed the need for impairment on a collective basis through analysing significant macroeconomic and sector specific developments, such as the impact of Brexit on property valuations, as well as the high street decline; and
- challenged management on loans of interest where indicators could point to issuer financial difficulty, obtaining evidence to assess whether the position taken by management is reasonable.

Key observations
We have determined that the £6 million impairment charge arising on non-performing credit assets is reasonable. In performing our procedures, we did not note any other indicators of material impairment.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Materiality	£28.0 million (2017: £28.0 million).	£25.2 million (2017: £25.2 million).
Basis for determining materiality	Materiality was determined as approximately 5.2% (2017: 5.2%) of three-year average profit before tax, excluding the impact of the Ogden discount rate change on year-end results.	Materiality equates to less than 1% (2017: 1%) of shareholders' equity and is capped at 90% (2017: 90%) of Group materiality.
Rationale for the benchmark applied	We determined that the critical benchmark for the Group was average profit before tax. This measure uses a three-year average of profit before tax which we deemed appropriate due to the inherent volatility of profits in the insurance industry. We also elected to exclude the impact of the Ogden discount rate change on the 2016 results and the subsequent move to 0% in 2018 results due to the non-recurring nature of these events. We also considered this measure to be suitable having compared to other benchmarks: our materiality equates to 4.8% (2017: 5.1%) of statutory profit before tax, 0.9% (2017: 0.8%) of gross earned premium and 1.1% (2017: 1.1%) of equity.	We determined that the critical benchmark for the Parent Company was shareholder's equity. This is because the Parent Company is not a trading entity but rather receives dividend income from its subsidiaries. When determining materiality for the Parent Company, we also considered the appropriateness of this materiality for the consolidation of this set of financial statements to the Group's results.

Group materiality is used for setting audit scope and the assessment of uncorrected misstatements. Materiality is set for each significant component in line with the components proportion of the chosen benchmark. This is capped at the lower of 90% of Group materiality and the component materiality determined for a standalone audit. The main UK insurance trading entity, UK Insurance Limited, which makes up 100% of Group gross earned premium and 73% of Group statutory profit before tax, is scoped to a component materiality of £25.2 million (2017: £25.2 million).

We determine performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality for the financial statements as a whole. We have set Group performance materiality at £19.6 million (2017: £19.6 million) and the audit testing for UK Insurance Limited is carried out to a performance materiality of £17.6 million (2017: £17.6 million).

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.4 million (2017: £1.4 million) for the Group financial statements, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

The scope of our Group audit was determined by obtaining an understanding of the Group and its environment, including group-wide controls, and assessing the risks of material misstatement at the Group level.

Consistent with the prior period, this resulted in two entities being subject to a full scope audit and a further two were subject to an audit of specified account balances where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations. All entities within scope of the Group audit are based in the UK.

These four entities represent the principal trading and service operations of the Group and account for 99% (2017: 99%) of the Group's net assets, 100% (2017: 100%) of the Group's gross earned premium and 98% (2017: 98%) of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above.

At the Group level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances. The Group audit team also performs the audit of the in-scope UK entities.

The Group audit team was responsible for all of the entities listed above, including the Parent Company.

Other information

The Directors are responsible for the other information. The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- fair, balanced and understandable – the statement given by the Directors that they consider the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit Committee reporting – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- Directors' statement of compliance with the UK Corporate Governance Code – the parts of the Directors' statement required under the Listing Rules relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We have nothing to report in respect of these matters

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud, are set out below.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

Identifying and assessing potential risks related to irregularities
In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

– enquiring of management, internal audit, legal counsel, financial reporting, risk, IT, financial crime and the Audit Committee, including obtaining and reviewing supporting documentation, concerning the Group's policies and procedures relating to:
  a) identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  b) detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  c) the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations.
– discussing among the engagement team and involving relevant internal specialists, including actuarial, tax, IT, valuations and pension specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas: the valuation of the insurance reserves as well as the valuation of the intangible assets due to the estimates and judgements exercised by management; and
– obtaining an understanding of the legal and regulatory framework that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the Group. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules and tax legislation. In addition, we considered compliance with the terms of the Group's regulatory solvency requirements when assessing the Group's ability to continue as a going concern.

Audit response to risks identified
As a result of performing the above, we identified valuation of insurance reserves and valuation of intangible assets as key audit matters. The key audit matters section of our report explains these matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

Our procedures to respond to risks identified included the following:

– reviewing the financial statement disclosures and testing the supporting documentation to assess compliance with relevant laws and regulations discussed above;
– enquiring of management, the Audit Committee and in-house legal counsel concerning actual and potential litigation and claims;
– performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
– reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with HMRC, PRA and FCA; and
– in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

– the information given in the strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
– the strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and the Parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the Directors' report.

Matters on which we are required to report by exception

Adequacy of explanations and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

– we have not received all the information and explanations we require for our audit; or
– adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
– the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Other matters

Audit tenure

Following the recommendation of the Audit Committee, we were appointed by the Board of Directors of the Royal Bank of Scotland Group plc on 21 March 2000 to audit the financial statements for the year ending 31 December 2000 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 19 years, covering the years ending 31 December 2000 to 31 December 2018.

Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the full extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

COLIN RAWLINGS FCA (SENIOR STATUTORY AUDITOR)
for and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

4 March 2019

CONSOLIDATED INCOME STATEMENT
For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Gross earned premium	5	3,306.7	3,339.7
Reinsurance premium	5	(217.2)	(204.7)
Net earned premium	5	3,089.5	3,135.0
Investment return	6	154.6	175.4
Instalment income		119.9	116.4
Other operating income	7	72.1	62.9
Total income		3,436.1	3,489.7
Insurance claims	8	(1,966.9)	(1,571.1)
Insurance claims recoverable from / (payable to) reinsurers	8	55.1	(183.1)
Net insurance claims	8	(1,911.8)	(1,754.2)
Commission expenses	9	(200.4)	(286.4)
Operating expenses	10	(722.2)	(806.3)
Total expenses		(922.6)	(1,092.7)
Operating profit		601.7	642.8
Finance costs	11	(19.1)	(103.8)
Profit before tax		582.6	539.0
Tax charge	12	(108.9)	(105.0)
Profit for the year attributable to owners of the Company		473.7	434.0
Earnings per share:			
Basic (pence)	15	33.5	31.8
Diluted (pence)	15	33.1	31.5

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Profit for the year		473.7	434.0
Other comprehensive income			
Items that will not be reclassified subsequently to the income statement:			
Actuarial gain on defined benefit pension scheme	25	2.7	2.1
Tax relating to item that will not be reclassified	13	(0.4)	(0.4)
		2.3	1.7
Items that may be reclassified subsequently to the income statement:			
Cash flow hedges		0.5	(1.1)
Fair value (loss) / gain on AFS investments	30	(121.4)	8.8
Less: realised net gains on AFS investments included in income statement	30	(19.5)	(23.2)
Tax relating to items that may be reclassified	30	23.9	2.5
		(116.5)	(13.0)
Other comprehensive loss for the year net of tax		(114.2)	(11.3)
Total comprehensive income for the year attributable to owners of the Company		359.5	422.7

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET
As at 31 December 2018

	Notes	2018 £m	2017 £m
Assets			
Goodwill and other intangible assets	17	**566.8**	471.1
Property, plant and equipment	18	**156.2**	174.4
Investment property	19	**322.1**	309.3
Reinsurance assets	21	**1,208.7**	1,178.5
Current tax assets	13	**–**	0.1
Deferred acquisition costs	22	**171.0**	185.4
Insurance and other receivables	23	**875.9**	981.2
Prepayments, accrued income and other assets		**128.0**	146.2
Derivative financial instruments	24	**48.2**	84.4
Retirement benefit asset	25	**17.0**	14.4
Financial investments	26	**4,737.8**	5,040.4
Cash and cash equivalents	27	**1,154.4**	1,358.6
Assets held for sale	28	**–**	4.2
Total assets		**9,386.1**	9,948.2
Equity			
Shareholders' equity		**2,573.1**	2,715.1
Tier 1 notes	31	**346.5**	346.5
Total equity		**2,919.6**	3,061.6
Liabilities			
Subordinated liabilities	32	**259.5**	264.7
Insurance liabilities	33	**4,005.9**	4,225.7
Unearned premium reserve	34	**1,505.5**	1,600.3
Borrowings	27	**62.0**	54.1
Derivative financial instruments	24	**25.9**	12.0
Trade and other payables, including insurance payables	36	**554.1**	658.0
Deferred tax liabilities	13	**7.6**	31.1
Current tax liabilities	13	**46.0**	40.7
Total liabilities		**6,466.5**	6,886.6
Total equity and liabilities		**9,386.1**	9,948.2

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 4 March 2019. They were signed on its behalf by:

PENNY JAMES
CHIEF FINANCIAL OFFICER

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Share capital (note 29) £m	Employee trust shares £m	Capital reserves (note 30) £m	AFS revaluation reserve (note 30) £m	Foreign exchange translation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes (note 31) £m	Total equity £m
Balance at 1 January 2017	150.0	(34.3)	1,450.0	92.1	1.4	862.3	2,521.5	–	2,521.5
Profit for the year	–	–	–	–	–	434.0	434.0	–	434.0
Other comprehensive loss	–	–	–	(11.9)	(1.1)	1.7	(11.3)	–	(11.3)
Dividends paid (note 14)	–	–	–	–	–	(225.3)	(225.3)	–	(225.3)
Shares acquired by employee trusts	–	(19.6)	–	–	–	–	(19.6)	–	(19.6)
Credit to equity for equity-settled share-based payments (note 35)	–	–	–	–	–	14.8	14.8	–	14.8
Shares distributed by employee trusts	–	19.8	–	–	–	(19.8)	–	–	–
Tax on share-based payments	–	–	–	–	–	1.0	1.0	–	1.0
Issue of Tier 1 notes	–	–	–	–	–	–	–	346.5	346.5
Balance at 31 December 2017	150.0	(34.1)	1,450.0	80.2	0.3	1,068.7	2,715.1	346.5	3,061.6
Profit for the year	–	–	–	–	–	473.7	473.7	–	473.7
Other comprehensive loss	–	–	–	(117.0)	0.5	2.3	(114.2)	–	(114.2)
Dividends and appropriations paid (note 14)	–	–	–	–	–	(503.8)	(503.8)	–	(503.8)
Shares acquired by employee trusts	–	(19.5)	–	–	–	–	(19.5)	–	(19.5)
Credit to equity for equity-settled share-based payments (note 35)	–	–	–	–	–	21.0	21.0	–	21.0
Shares distributed by employee trusts	–	18.4	–	–	–	(18.4)	–	–	–
Tax on share-based payments	–	–	–	–	–	0.8	0.8	–	0.8
Balance at 31 December 2018	150.0	(35.2)	1,450.0	(36.8)	0.8	1,044.3	2,573.1	346.5	2,919.6

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT
For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Net cash generated from operating activities before investment of insurance assets	37	4.2	204.0
Cash generated from investment of insurance assets	37	468.1	341.9
Net cash generated from operating activities		472.3	545.9
Cash flows used in investing activities			
Purchases of property, plant and equipment	18	(13.3)	(22.4)
Purchases of goodwill and other intangible assets	17	(142.4)	(73.2)
Proceeds on disposals of assets held for sale		13.8	–
Proceeds on disposal of property, plant and equipment		0.1	0.3
Net cash used in investing activities		(141.8)	(95.3)
Cash flows used in financing activities			
Net proceeds from issue of Tier 1 notes	31	–	346.5
Repayment of subordinated liabilities		–	(326.8)
Dividends and appropriations paid	14	(503.8)	(225.3)
Finance costs		(19.3)	(31.7)
Purchase of employee trust shares		(19.5)	(19.6)
Net cash used in financing activities		(542.6)	(256.9)
Net (decrease) / increase in cash and cash equivalents		(212.1)	193.7
Cash and cash equivalents at the beginning of the year	27	1,304.5	1,110.8
Cash and cash equivalents at the end of the year	27	1,092.4	1,304.5

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

Corporate information

Direct Line Insurance Group plc is a public limited company registered in England and Wales (company number 02280426). The address of the registered office is Churchill Court, Westmoreland Road, Bromley, BR1 1DP, England.

1. Accounting policies

Basis of preparation

As required by the Companies Act 2006 and Article 4 of the EU IAS Regulation, the consolidated financial statements are prepared in accordance with IFRSs issued by the IASB as adopted by the EU. The Company's financial statements have been prepared in accordance with and in full compliance with IFRSs as issued by the IASB. The Company has elected to prepare its parent entity financial statements in accordance with FRS 101 'Reduced Disclosure Framework'.

The consolidated financial statements are prepared on the historical cost basis except for available-for-sale ("**AFS**") financial assets, investment property and derivative financial instruments, which are measured at fair value (fair value is defined in note 40).

The Company's financial statements and the consolidated financial statements are presented in sterling, which is the functional currency of the Company.

Adoption of new and revised standards

The Group has adopted the following new amendments to IFRSs and International Accountings Standards ("**IASs**") that became mandatorily effective for the Group for the first time during 2018 however these had no material impact on the consolidated financial statements or performance.

IFRS 15 'Revenue from Contracts with Customers' introduces new recognition and disclosure requirements. Entities are required to recognise revenue as goods and services are transferred to the customer in proportion to the total consideration it expects to receive in exchange for those services. The Group has adopted the standard on a fully retrospective basis. This has not had a material impact on the consolidated financial statements.

Insurance contracts are out of scope of IFRS 15.

Amendments to IFRS 4: 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' was issued on 12 September 2016 and endorsed by the EU on 3 November 2017. These amendments permitted insurers who satisfied certain criteria to defer the effective date of IFRS 9 'Financial Instruments', to coincide with the expected effective date of IFRS 17 'Insurance Contracts', to 1 January 2022. The IASB permitted this option having considered potential asset and liability mismatching and temporary profit and loss volatility caused by introducing these new standards in different periods within a short period of time.

When first published, Amendments to IFRS 4 required insurance entities to evaluate whether their activities were predominantly connected to insurance as at its annual reporting date immediately preceding 1 April 2016, providing an option to defer adoption of IFRS 9 if liabilities connected to insurance comprised a predominant proportion of its total liabilities as at that date. The Group concluded that it satisfied the criteria that the carrying value of its liabilities connected to insurance was greater than 90% of the carrying value of its total liabilities at 31 December 2015. In making this conclusion, the Group determined that the subordinated debt of £521.1 million and derivative liabilities of £46.4 million represented liabilities connected with insurance but not liabilities arising from contracts within the scope of IFRS 4. There have been no significant changes in the Group's activities since this assessment to require a reassessment of the criteria.

The fair value at the end of the reporting period for financial assets with contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount are disclosed in note 40. The amount of change in the fair value during the period for these financial assets was: AFS debt securities £103.7 million decrease, held-to-maturity ("**HTM**") debt securities £3.2 million decrease, infrastructure debt £18.2 million decrease and commercial real estate loans had a small increase.

Derivative assets do not have contractual terms that give rise on specified dates to cash flows that are solely payment of principal and interest on the principal amount outstanding. The fair value of these financial assets is disclosed in note 40 and the amount of change in the fair value during the period was £26.7 million.

In note 3.3.3 the Group has disclosed the carrying amount of financial assets at the end of the reporting period by credit risk rating grade, as defined in IFRS 7 'Financial Instruments: Disclosures'. The fair value and the carrying amount of financial assets that meet the solely payments of principal and interest criteria and, at the end of the reporting period do not have a low credit risk, was £393.9 million.

IFRS 9 information that relates to entities within the Group that is not provided in the Group's consolidated financial statements can be obtained from their individual financial statements. This information will be available from Companies House once the individual financial statements have been approved and filed with Companies House.

The IASB amended IFRS 2 'Share-based Payment' to provide further clarity on: the effects of vesting conditions on the measurement of cash-settled share-based payment transactions; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled.

The Group operates equity-settled share-based schemes only and has no obligation to withhold tax in respect of the employee's personal tax liability. These amendments have no impact on the Group's share-based payments accounting policy.

A number of further narrow scope amendments which became effective for the Group but do not have an impact on existing accounting policies, are as follows:

The IASB amended IAS 40 'Investment Property' to clarify when an entity should categorise a property as an investment property. Property should be transferred to or from investment property when there is evidence of a change in use meaning the property now satisfies, or ceases to satisfy, the definition of an investment property.

IFRIC 22 'Foreign Currency Transactions and Advance Consideration' clarifies how to determine the date of the transaction for the exchange rate to be used on the initial recognition where an entity pays or receives consideration in advance for foreign currency denominated contracts.

Annual Improvements to IFRS Standards 2014–2016 Cycle relating to IFRS 1 'First-time Adoption of International Financial Reporting Standards' – the amendment deletes certain short-term exemptions for first-time adopters, and IAS 28 'Investments in Associates and Joint Ventures' – the amendment provides clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice.

1.1 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and the entities that are controlled by the Group at 31 December 2018 and 31 December 2017. Control exists when the Group is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing if the Group controls another entity, the existence and effect of the potential voting rights that are currently exercisable or convertible are considered.

Where necessary, adjustments have been made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. The policies set out below have been applied consistently throughout the years ended 31 December 2018 and 31 December 2017 to items considered material to the consolidated financial statements.

A subsidiary acquired is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at fair value.

All intercompany transactions, balances, income and expenses between Group entities are eliminated on consolidation.

1.2 Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the presentational currency of the Group. Group entities record transactions in the currency of the primary economic environment in which they operate (their functional currency), translated at the foreign exchange rate ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in the income statement.

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in the income statement except for differences arising on AFS non-monetary financial assets, which are recognised in other comprehensive income.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at the foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in the consolidated statement of comprehensive income. The amount accumulated in equity is reclassified from equity to the consolidated income statement on disposal or partial disposal of a foreign operation.

1.3 Contract classification

Insurance contracts are those contracts where the Group (the insurer) has accepted significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished.

1.4 Revenue recognition

Premiums earned

Insurance and reinsurance premiums comprise the total premiums receivable for the whole period of cover provided by contracts incepted during the financial year, adjusted by an unearned premium provision, which represents the proportion of the premiums incepted in the year or prior periods that relate to periods of insurance cover after the balance sheet date. Unearned premiums are calculated over the period of exposure under the policy, on a daily basis, 24ths basis or allowing for the estimated incidence of exposure under policies.

Premiums collected by intermediaries or other parties, but not yet received, are assessed based on estimates from underwriting or past experience and are included in insurance premiums. Insurance premiums exclude insurance premium tax or equivalent local taxes and are shown gross of any commission payable to intermediaries or other parties.

Cash back payments to policyholders under motor telematics policies represent a reduction in earned premiums.

Investment return

Interest income on financial assets is determined using the effective interest rate method. The effective interest rate method is a way of calculating the amortised cost of a financial asset (or group of financial assets) and of allocating the interest income over the expected life of the asset.

Rental income from investment property is recognised in the income statement on a straight-line basis over the period of the contract. Any gains or losses arising from a change in fair value are recognised in the income statement.

Instalment income

Instalment income comprises the interest income earned on policyholder receivables, where outstanding premiums are settled by a series of instalment payments. Interest is earned using an effective interest rate method over the term of the policy.

Other operating income

Vehicle replacement referral income

Vehicle replacement referral income comprises fees recognised at a point in time in respect of referral income received when a customer or a non-fault policyholder (claimant) of another insurer has been provided with a hire vehicle from a preferred supplier.

Income is recognised when the customer or claimant has been provided with a vehicle by the supplier.

Revenue from vehicle recovery and repair services

Fees in respect of services for vehicle recovery are recognised at a point in time on satisfaction of performance obligations. The cost of providing the service is incurred as the service is rendered.

1.4 Revenue recognition continued

The Group's income also comprises vehicle repair services provided to other third-party customers. Income in respect of repairs to vehicles is recognised upon completion of the repair obligations. The price is determined using market rates for the services and materials used after discounts have been deducted where applicable.

Legal services income

Legal services income represents the amount charged to clients for professional services provided during the year including recovery of expenses but excluding value added tax. Income relating to variable legal services fees is recognised on a best estimate basis.

Other income

Commission fee income in respect of services is recognised at a point in time on satisfaction of related performance obligations. Where fees have a variable element, income is recognised on a best estimate of the total consideration expected. Income is stated excluding applicable sales taxes.

1.5 Insurance claims

Insurance claims are recognised in the accounting period in which the loss occurs. Provision is made for the full cost of settling outstanding claims at the balance sheet date, including claims incurred but not yet reported at that date, net of salvage and subrogation recoveries. Outstanding claims provisions are not discounted for the time value of money except for claims to be settled by PPOs established under the Courts Act 2003.

A court can award damages for future pecuniary loss in respect of personal injury or for other damages in respect of personal injury and may order that the damages are wholly or partly to take the form of PPOs. These are covered in more detail in note 2.4. Costs for both direct and indirect claims handling expenses are also included.

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions. When calculating the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims (gross and net) at the balance sheet date. Also included in the estimation of outstanding claims are factors such as the potential for judicial or legislative inflation.

Provisions for more recent claims make use of techniques that incorporate expected loss ratios and average claims cost (adjusted for inflation) and frequency methods. As claims mature, the provisions are increasingly driven by methods based on actual claims experience. The approach adopted takes into account the nature, type and significance of the business and the type of data available, with large claims generally being assessed separately. The data used for statistical modelling purposes is generated internally and reconciled to the accounting data.

The calculation is particularly sensitive to the estimation of the ultimate cost of claims for the particular classes of business at gross and net levels and the estimation of future claims handling costs. Actual claims experience may differ from the historical pattern on which the actuarial best estimate is based and the cost of settling individual claims may exceed that assumed. As a result, the Group sets provisions at a margin above the actuarial best estimate. This amount is recorded within claims provisions.

A liability adequacy provision is made for unexpired risks arising where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premium reserve in relation to such policies after the deduction of any acquisition costs deferred and other prepaid amounts (for example, reinsurance). The expected value is determined by reference to recent experience and allowing for changes to the premium rates. The provision for unexpired risks is calculated separately by reference to classes of business that are managed together after taking account of relevant investment returns.

1.6 Reinsurance

The Group has reinsurance treaties and other reinsurance contracts that transfer significant insurance risk.

The Group cedes insurance risk by reinsurance in the normal course of business, with the arrangement and retention limits varying by product line. Outward reinsurance premiums are generally accounted for in the same accounting period as the premiums for the related direct business being reinsured. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate.

Reinsurance assets include balances due from reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a consistent manner with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract. Recoveries in respect of PPOs are discounted for the time value of money.

A reinsurance bad debt provision is assessed in respect of reinsurance debtors, to allow for the risk that the reinsurance asset may not be collected or where the reinsurer's credit rating has been downgraded significantly and this is taken as an indication of a reinsurer's difficulty in meeting its obligations under the reinsurance contracts. This also includes an assessment in respect of the ceded part of claims provisions to reflect the counterparty default risk exposure to long-term reinsurance assets particularly in relation to PPOs. Increases in this provision affect the Group by reducing the carrying value of the asset and the impairment loss is recognised in the income statement.

1.7 Deferred acquisition costs

Acquisition costs relating to new and renewing insurance policies are matched with the earning of the premiums to which they relate. A proportion of acquisition costs incurred during the year is therefore deferred to the subsequent accounting period to match the extent to which premiums written during the year are unearned at the balance sheet date.

The principal acquisition costs deferred are direct advertising expenditure, directly attributable administration costs, commission paid and costs associated with telesales and underwriting staff.

1.8 Goodwill and other intangible assets

Acquired goodwill, being the excess of the cost of an acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, associate or joint venture acquired, is initially recognised at cost and subsequently at cost less any accumulated impairment losses. Goodwill arising on the acquisition of subsidiaries, associates and joint ventures is included in the balance sheet category 'goodwill and other intangible assets'. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement over the assets' economic lives using methods that best reflect the pattern of economic benefits and is included in operating expenses. The estimated useful economic lives are as follows:

Software development costs	Up to 10 years

Expenditure on internally generated goodwill and brands is written off as incurred. Direct costs relating to the development of internal-use computer software and associated business processes are capitalised once technical feasibility and economic viability have been established. These costs include payroll costs, the costs of materials and services and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the projected benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred, as are all training costs and general overheads.

1.9 Property, plant and equipment

Items of property, plant and equipment (except investment property – note 1.11) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold and leasehold buildings	50 years or the period of the lease if shorter
Vehicles	3 years
Computer equipment	Up to 5 years
Other equipment, including property adaptation costs	2 to 15 years

The gain or loss arising from the derecognition of an item of property, plant and equipment is determined as the difference between the disposal proceeds, if any, and the carrying amount of the item.

1.10 Impairment of intangible assets, goodwill and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, goodwill or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss, if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. If an asset does not generate cash flows that are independent of those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit ("**CGU**") to which the asset belongs. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

Value in use is the present value of future cash flows from the asset or CGU, discounted at a rate that reflects market interest rates, adjusted for risks specific to the asset or CGU that have not been reflected in the estimation of future cash flows.

If the recoverable amount of an intangible or a tangible asset is less than its carrying value, an impairment loss is recognised immediately in the income statement and the carrying value of the asset is reduced by the amount of the impairment loss.

A reversal of an impairment loss on intangible assets or property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed the carrying amount that would have been determined had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

1.11 Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value based on valuations by independent registered valuers. Fair value is based on current prices for similar properties adjusted for the specific characteristics of each property. Any gain or loss arising from a change in fair value is recognised in the income statement.

Investment property is derecognised when it has been either disposed of or permanently withdrawn from use and no future economic benefit is expected from disposal. Any gains or losses on the retirement or disposal of investment property are recognised in the income statement in the year of retirement or disposal.

1.12 Financial assets

Financial assets are classified as AFS, HTM designated at fair value through profit or loss, or loans and receivables.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place are recognised on the date that the Group commits to purchase or sell the asset.

Available-for-sale
Financial assets can be designated as AFS on initial recognition. AFS financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Impairment losses and exchange differences resulting from translating the amortised cost of foreign currency monetary AFS financial assets are recognised in the income statement, together with interest calculated using the effective interest rate method. Other changes in the fair value of AFS financial assets are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in the income statement.

A financial asset is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The appropriate quoted market price for an asset held is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (for example, a change in the risk-free interest rate following the most recent price quote for a corporate bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. The valuation methodology described above uses observable market data.

1.12 Financial assets continued

If the market for a financial asset is not active, the Group establishes the fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable and willing parties (if available), reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Group uses that technique.

Held-to-maturity

Non-derivative financial assets not designated as AFS or loans and receivables with fixed or determinable payments and fixed maturity where the intention and ability to hold them to maturity exists are classified as HTM.

Subsequent to initial recognition, HTM financial assets are measured at amortised cost using the effective interest rate method less any impairment losses.

Loans and receivables

Non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as AFS or HTM. Loans and receivables are initially recognised at fair value plus directly related transaction costs and are subsequently measured at amortised cost using the effective interest rate method less any impairment losses.

Impairment of financial assets

At each balance sheet date, the Group assesses whether there is any objective evidence that a financial asset or group of financial assets classified as AFS, HTM or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Available-for-sale

When a decline in the fair value of a financial asset classified as AFS has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in the income statement. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on AFS equity instruments are not reversed through profit or loss, but those on AFS debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

Held-to-maturity and loans and receivables

If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as HTM or loans and receivables has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets, discounted at the effective interest rate of the instrument at initial recognition.

Impairment losses are assessed individually where significant or collectively for assets that are not individually significant.

Impairment losses are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses. If in a subsequent period the amount of the impairment loss reduces, and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance.

Insurance receivables

Insurance receivables comprise outstanding insurance premiums where the policyholders have elected to pay in instalments or amounts due from third parties where they have collected or are due to collect the money from the policyholder.

Receivables also include amounts due in respect of the provision of legal services.

For amounts due from policyholders, the bad debt provision is calculated based upon prior loss experience. For all balances outstanding in excess of three months, a bad debt provision is made. Where a policy is subsequently cancelled, the outstanding debt that is overdue is charged to the income statement and the bad debt provision is released back to the income statement.

Derivatives and hedging

Derivative financial instruments are recognised initially, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

Gains and losses arising from changes in the fair value of a derivative are recognised as they arise in the income statement unless the derivative is the hedging instrument in a qualifying hedge. The Group enters into fair value hedge relationships and a small amount of cash flow hedges.

Hedge relationships are formally documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in cash flows and fair values attributable to the hedged risk, consistent with the documented risk management strategy, or if the hedging instrument expires or is sold, terminated or exercised, hedge accounting is discontinued.

In a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity. Any ineffective portion is recognised in the income statement.

In a fair value hedge, the gain or loss on the hedging instrument is recognised in the income statement. The gain or loss on the hedged item attributable to the hedged risk is recognised in the income statement and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item.

Derecognition of financial assets

A financial asset is derecognised when the rights to receive the cash flows from that asset have expired or when the Group has transferred its rights to receive cash flows from the asset and has transferred substantially all the risk and rewards of ownership of the asset.

1.13 Cash and cash equivalents and borrowings

Cash and cash equivalents comprise cash in hand and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

Borrowings, comprising bank overdrafts, are measured at amortised cost using the effective interest rate method.

1.14 Financial liabilities

Financial liabilities are initially recognised at fair value net of transaction costs incurred. Other than derivatives which are recognised and measured at fair value, all other financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

1.15 Subordinated liabilities

Subordinated liabilities comprise subordinated guaranteed dated notes which are initially measured at the consideration received less related transaction costs. Subsequently, subordinated liabilities are measured at amortised cost using the effective interest rate method.

1.16 Provisions

The Group recognises a provision for a present legal or constructive obligation from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount can be reliably estimated.

The Group makes provision for all insurance industry levies, such as the Financial Services Compensation Scheme and Motor Insurance Bureau.

When the Group has an onerous contract, it recognises the present obligation under the contract as a provision. A contract is onerous when the unavoidable costs of meeting the contractual obligations exceed the expected future economic benefit. In respect of leasehold properties, a provision is recognised when the Group has a detailed formal plan to vacate the leasehold property, or significantly reduce its level of occupancy, the plan has been communicated to those affected and the future property costs under the lease exceed future economic benefits.

Restructuring provisions are made, including redundancy costs, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan and has communicated the plan to those affected.

1.17 Leases

Payments made under operating leases are charged to the income statement on a straight-line basis over the term of the lease.

1.18 Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

Contributions to the Group's defined contribution pension scheme are recognised in the income statement when payable.

The Group's defined benefit pension scheme, as described in note 25, was closed in 2003. Scheme liabilities are measured on an actuarial basis, using the projected unit credit method, and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs, together with the net interest on net pension liability or asset, is charged or credited to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside the income statement and presented in other comprehensive income under 'Items that will not be reclassified subsequently to the income statement'.

1.19 Taxation

The tax charge or credit represents the proportion of the tax payable and receivable arising in the current year only.

The current tax charge is based on the taxable profits for the year as determined in accordance with the relevant tax legislation, after any adjustments in respect of prior years. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Provision for taxation is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date and is allocated over profits before taxation and amounts charged or credited to components of other comprehensive income and equity, as appropriate.

Deferred taxation is accounted for in full using the balance sheet liability method on all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes.

Deferred tax liabilities are generally recognised for all taxable temporary timing differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is probable that they will not be recovered.

Deferred tax assets and liabilities are calculated at the tax rates expected to apply when the assets are realised or liabilities are settled based on laws and rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited to other comprehensive income or equity, in which case the deferred tax is also dealt with in other comprehensive income or directly in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current assets and liabilities on a net basis.

1.20 Share-based payment

The Group operates a number of share-based compensation plans under which it awards Ordinary Shares and share options to its employees. Such awards are generally subject to vesting conditions that vary the amount of cash or shares to which an employee is entitled.

Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the Group to meet specified performance targets).

1.20 Share-based payment continued

The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility.

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of the Company's Ordinary Shares).

The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

1.21 Capital instruments

The Group classifies a financial instrument that it issues as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms, or as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities.

The Tier 1 notes are classified as equity as they have a perpetual maturity and the Group has full discretion over interest payments, including ability to defer or cancel interest payments indefinitely.

The consideration for any Ordinary Share of the Company purchased by the Group for the benefit of the employee trusts is deducted from equity.

1.22 Dividends

Interim dividends on Ordinary Shares are recognised in equity in the period in which they are paid. Final dividends on Ordinary Shares are recognised when they have been approved at the AGM.

1.23 Accounting developments

New IFRSs and amendments that are issued, but not yet effective for the 31 December 2018 reporting period and have not been early adopted by the Group are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective, except for IFRS 9 as explained below.

The IASB issued IFRS 16 'Leases' in January 2016 to replace IAS 17 'Leases' and will be effective for reporting periods beginning on or after 1 January 2019, applied by the Group fully retrospectively from this date. IFRS 16 sets out the principles for recognition, measurement and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. There are two exemptions: for leases of a low value and for leases of a short-term nature of 12 months or less. At the start of the lease a lessee will recognise a liability for the lease payments and an asset, representing the right to use the asset during the lease term. Lessees will be required to separately recognise the interest on the lease liability and the depreciation expense on the right-of-use asset. Lessor accounting under IFRS 16 is substantially unchanged from the current approach under IAS 17.

The Group expects to recognise right-of-use assets of approximately £150.0 million on 1 January 2019 and lease liabilities of approximately £165.0 million. The reduction to equity after tax is approximately £15.0 million. From 1 January 2019 lease charges previously recognised as rental expenses in profit or loss will instead comprise depreciation and finance costs. The profit or loss impact, had this standard been adopted on 1 January 2018, would have been a reduction in operating expenses of approximately £5 million and an increase in finance costs of approximately £7 million in the 2018 consolidated income statement.

The actual impacts may differ from the amounts presented above when the Group presents its first financial statements from the initial date of application.

In July 2014, the IASB issued the final version of IFRS 9 which replaces IAS 39 'Financial Instruments: Recognition and Measurement' and all previous versions of IFRS 9; it was endorsed by the EU in 2016. IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets; it is effective for annual periods beginning on or after 1 January 2018.

In September 2016, the IASB issued amendments to IFRS 4 to address issues arising from the different effective dates of IFRS 9 and IFRS 17. The amendments to IFRS 4 were endorsed by the EU in November 2017.

The Group conducted a high-level assessment of the three aspects of IFRS 9 and based on current information, the impact of applying the expected loss model for the first time is currently immaterial. The Group does not expect any other significant impact on its financial statements. The Group satisfies the exemption criteria within IFRS 4 and has decided to defer the application of IFRS 9 until the expected effective date of the new insurance contracts standard IFRS 17, on 1 January 2022, applying the temporary exemption from applying IFRS 9 as introduced by the amendments to IFRS 4.

Amendments to IFRS 9: 'Prepayment Features with Negative Compensation' was issued in October 2017 to allow instruments with symmetric prepayment options to qualify for amortised cost or fair value through other comprehensive income measurement because they would otherwise fail the 'solely payments of principal and interest on the principal amount' condition. The amendments are effective from the same period as IFRS 9.

IFRS 17 was issued by the IASB in May 2017 to replace IFRS 4 and is expected to be effective for reporting periods beginning on or after 1 January 2022, with comparative figures required. IFRS 17 is a comprehensive new accounting standard for all insurance contracts covering recognition and measurement, presentation and disclosure. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers and to replace the requirements of IFRS 4 that allowed insurers to apply grandfathering of previous local accounting policies.

The core of IFRS 17 is the general model, supplemented by an optional simplified premium allocation approach which is permitted for the liability for the remaining coverage for short duration contracts (one year or less). The general model measures insurance contracts using the building blocks of:

discounted probability weighted cash flows; an explicit risk adjustment; and a contractual service margin representing the unearned profit of the contract which is recognised as revenue over the coverage period.

An assessment on the impact of IFRS 17 on the Group's financial statements is in progress. The Group expects to be able to apply the simplified premium allocation approach to most of its insurance and reinsurance contracts.

The following accounting developments are not expected to have a material impact on the Group's financial statements in future periods:

Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures was issued in October 2017 to clarify that an entity applies IFRS 9 to long-term interests in associates or joint ventures that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendments are effective from 1 January 2019.

IFRIC 23 'Uncertainty over Income Tax Treatments' was issued in June 2017 and provides interpretation when there is uncertainty over income tax treatments under IAS 12 'Income Taxes'. This is effective from 1 January 2019.

Amendments to IAS 19 'Employee Benefits': Plan Amendment, Curtailment or Settlement was issued in February 2018. The amendments clarify the accounting when a plan amendment, curtailment or settlement occurs. This is effective from 1 January 2019.

In December 2017 the IASB issued 'Annual Improvements to IFRS Standards 2015-2017 Cycle' with an effective date of 1 January 2019, which included the following three amendments:

IFRS 3 'Business Combinations' and IFRS 11 'Joint Arrangements' – the amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business; the amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.

IAS 12 'Income Taxes' – the amendments clarify that all income tax consequences of dividends should be recognised in profit or loss, regardless of how the tax arises.

IAS 23 'Borrowing Costs'– the amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

In March 2018 the IASB issued 'Amendments to References to the Conceptual Framework in IFRS Standards' – amending some references to previous versions of the *Conceptual Framework* in IFRS Standards and their accompanying documents and IFRS Practice Statements. This is effective from 1 January 2020.

In October 2018 the IASB issued 'Amendments to IFRS 3 Business Combinations' – this will permit a simplified assessment of whether an acquired set of activities and assets is a group of assets rather than a business. This is effective from 1 January 2020.

In October 2018 the IASB issued 'Amendments to IAS 1 and IAS 8 Definition of Material' – this clarifies and aligns the definition of 'material' and provides guidance to help improve consistency in the application of that concept whenever it is used in IFRS Standards. This is effective from 1 January 2020.

2. Critical accounting judgements and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underline the preparation of its financial information. The Group's principal accounting policies are set out on pages 136 to 143. Company law and IFRSs require the Directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent.

In the absence of an applicable standard or interpretation, IAS 8 'Accounting policies, Changes in Accounting Estimates and Errors' requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below.

2.1 Impairment provisions – financial assets

The Group makes a judgement that financial assets are impaired when there is objective evidence that an event or events since initial recognition of the assets have adversely affected the amount or timing of future cash flows from the asset. The determination of which events could have adversely affected the amount or timing of future cash flows from the asset requires judgement. In making this judgement, the Group evaluates, among other factors, the normal price volatility of the financial asset, the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flow or whether there has been a significant or prolonged decline in the fair value of the asset below its cost. Impairment may be appropriate when there is evidence of deterioration in these factors.

On a quarterly basis, the Group reviews whether there is any objective evidence that a financial asset is impaired based on the following criteria:

- actual, or imminent, default on coupon interest or nominal;
- adverse movements in the credit rating for the investee / borrower;
- price performance of a particular AFS debt security, or group of AFS debt securities, demonstrating an adverse trend compared to the market as a whole; and
- an event has occurred that could be reliably estimated and which had an impact on the financial asset or its future cash flows.

The Group has made a judgement that there was objective evidence of impairment of an asset within the loan and receivables portfolio in the year ended 31 December 2018. The Group has also made an estimation of the recoverable value of the loan and this resulted in an impairment charge of £6.0 million (2017: £9.5 million).

Had all the declines in AFS asset values met the criteria above at 31 December 2018, the Group would suffer a loss of £21.0 million (2017: £6.5 million), being the transfer of the total AFS reserve for unrealised losses to the income statement. These movements represent mark-to-market movements and where there is no objective evidence of any loss events that could affect future cash flows, no impairments have therefore been recorded for these movements.

2.2 Fair value

The Group has made the judgement that level 1 of the Group's fair value hierarchy set out in note 40 will include only sovereign debt securities issued by members of the G10 group of countries within the Group's AFS debt securities portfolio, with all other financial assets and liabilities carried at fair value included in level 2 as they are not considered to be quoted in a deeply liquid market.

The Group has also made the judgement that investment properties, most of the HTM debt securities, commercial real estate loans and infrastructure debt fall within level 3 of the Group's fair value hierarchy (note 40) as the valuation models used are driven predominantly by unobservable inputs: investment property valuations are derived from recent market transactions which are adjusted for specific characteristics of each property including the size, location and condition by reference to the benchmark property transactions.

2.3 Goodwill and other intangible assets

Goodwill impairment testing inherently involves estimation uncertainty in a number of areas including: the preparation of the five-year strategic plan and the extrapolation of cash flow forecasts beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the CGUs; estimation of market values of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Details of a sensitivity analysis on the recoverable amount in excess of carrying value are shown in note 17.

Judgement is applied to determine whether intangible assets are impaired. In making this judgement, the Group considers: the projection of the economic benefits associated with each asset; subsequent re-measurement of these benefits through the development cycle and into use; the projected ultimate cost of each asset at each point through the development cycle due to specification changes; and the likelihood of obsolescence of any component parts. Details of intangible assets are shown in note 17.

2.4 General insurance: outstanding claims provisions and related reinsurance recoveries

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling costs. Outstanding claims provisions net of related reinsurance recoveries at 31 December 2018 amounted to £2,900.7 million (2017: £3,144.5 million).

Claims reserves are assessed separately for large and attritional claims, typically using standard actuarial methods of projection. Key sources of estimation uncertainty include those arising from the selection of specific methods as well as assumptions for claims frequency and severity through the review of historical claims and emerging trends.

The corresponding reinsurance recoveries and impairment provision are calculated on an equivalent basis, with similar estimation uncertainty, as discussed in note 1.6. The reinsurance bad debt provision is mainly for expected recoveries against future PPO payments.

The most common method of settling bodily injury claims is by a lump sum paid to the claimant and, in the cases where this includes an element of indemnity for recurring costs such as loss of earnings or ongoing medical care, settlement calculations have reference to a standardised annuity factor at a discount rate normally referenced to as the Ogden discount rate. The Ogden discount rate was at 2.5% from 2001 until 2017, when it was changed to minus 0.75% based on a 3-year average of yields on index-linked Government securities, in line with case law that claimants were entitled to invest their lump sum in a way which was very low or even zero risk. The Civil Liability Act 2018 changes this approach and instead requires the Government to reset the Ogden discount rate by reference to low risk rather than very low or zero risk investments. The process is due to conclude in 2019, but there is considerable uncertainty about its outcome and the date from which a new rate will apply.

The Group will continue to exercise judgement around the Ogden discount rate used in its reserves. Risks and uncertainties here are significant but the move to introduce additional asset classes into the assumed claimant portfolio points towards a higher rate than minus 0.75%. The Group has therefore made a judgement that it is likely that the Ogden discount rate will change and has selected an estimate of 0% to value its lump sum bodily injury reserves. An allowance for further movements in the Ogden discount rate is made within the Group's solvency II balance sheet and capital requirements. Details of the IFRS sensitivity analysis to the assumed Ogden discount rate are shown in note 3.3.1.

The Group settles some large bodily injury claims as PPOs rather than lump sum payments.

The table below analyses the outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2018 and 31 December 2017. These represent the total cost of PPOs rather than any costs in excess of purely Ogden-based settlements.

At 31 December	Discounted 2018 £m	Undiscounted 2018 £m	Discounted 2017 £m	Undiscounted 2017 £m
Gross claims				
Approved PPO claims provisions	516.2	1,424.5	524.9	1,460.3
Anticipated PPOs	358.1	943.9	373.8	974.7
Total	874.3	2,368.4	898.7	2,435.0
Reinsurance				
Approved PPO claims provisions	(268.6)	(784.5)	(276.5)	(806.8)
Anticipated PPOs	(245.2)	(701.1)	(240.4)	(680.7)
Total	(513.8)	(1,485.6)	(516.9)	(1,487.5)
Net of reinsurance				
Approved PPO claims provisions	247.6	640.0	248.4	653.5
Anticipated PPOs	112.9	242.8	133.4	294.0
Total	360.5	882.8	381.8	947.5

The provisions for PPOs have been categorised as either claims which have already been determined by the courts as PPOs (approved PPO claims provisions) or those expected to settle as PPOs in the future (anticipated PPOs). The Group has made a judgement on the likelihood of large bodily injury claims settling as PPOs. The anticipated PPOs in the table above are based on historically-observed propensities adjusted for the assumed Ogden discount rate. They do not allow for any future changes in PPO propensity. Anticipated PPOs consist of both existing large loss case reserves including allowances for development and claims yet to be reported to the Group. Reinsurance is applied at claim level and the net cash flows are discounted for the time value of money. The discount rate is consistent with the long duration of the claims payments and the assumed future indexation of the claims payments.

In the majority of cases, the inflation agreed in the settlement is the Annual Survey of Hours and Earnings SOC 6115 inflation published by the Office for National Statistics, for which the long-term rate is assumed to be 4% (2017: 4%). The Group has estimated a rate of interest used for the calculation of present values as 4% (2017: 4%), which results in a real discount rate of 0% (2017: 0%). The Group will continue to exercise judgement around the inflation and discount rates used to calculate these insurance reserves.

Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.3.1.

3. Risk management

3.1 Enterprise Risk Management Strategy and Framework

The Enterprise Risk Management Strategy and Framework sets out, at a high level, our approach and processes for managing risks. Further information can be found in the risk management section of the strategic report on page 45.

3.2 Risk and capital management modelling

The Board has ultimate responsibility for ensuring that the Group has sufficient funds to meet its liabilities as they fall due. The Group carries out detailed modelling of its assets, liabilities and the key risks to which these are exposed. This modelling includes the Group's own assessment of its SCR, using its Partial Internal Model approved by the PRA in 2016. The SCR quantifies the insurance, market, credit, operational and liquidity risks that the regulated entities are undertaking.

The Board is closely involved in the SCR process and reviews, challenges and approves its assumptions and results.

3.3 Principal risks from insurance activities and use of financial instruments

There is considerable uncertainty as to the effect of Brexit on the Group and we have proactively considered a variety of possible implications of a disruptive 'hard' Brexit, including of a financial and operational nature; these are referred to in the risk management section of the strategic report.

The risk management section of the strategic report also sets out all the risks assessed by the Group as principal risks. Detailed below is the Group's risk exposure arising from its insurance activities and use of financial instruments specifically in respect of insurance risk, market risk, credit risk, operational risk and liquidity risk.

3.3.1 Insurance risk

The Group is exposed to insurance risk as a primary consequence of its business. Key insurance risks focus on the risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting.

The Group is mainly exposed to the following insurance risks:

Reserve risk

Reserve risk relates to both premium and claims. This is the risk of understatement or overstatement of reserves arising from:

– the uncertain nature of claims;

– data issues and changes to the claims reporting process;

– operational failures;

– failure to recognise claims trends in the market; and

– changes in underwriting and business written so that past trends are not necessarily a predictor of the future.

Understatement of reserves may result in not being able to pay claims when they fall due. Alternatively, overstatement of reserves can lead to a surplus of funds being retained resulting in opportunity cost; for example, lost investment return or insufficient resource to pursue strategic projects and develop the business.

Reserve risk is controlled through a range of processes:

– regular reviews of the claims and premiums, along with an assessment of the requirement for a liability adequacy provision for the main classes of business by the internal actuarial team;

– the use of external actuaries to review periodically the actuarial best estimate reserves produced internally, either through peer review or through provision of independent reserve estimates;

– accompanying all reserve reviews with actuarial assessment of the uncertainties through a variety of techniques including bootstrapping and scenario analysis;

– oversight of the reserving process by relevant senior management and the Board;

– regular reconciliation of the data used in the actuarial reviews against general ledger data and reconciliation of the claims data history against the equivalent data from prior reviews; and

– regular assessment of the uncertainty in the reserves to help the Board set management best estimate reserves.

The Group's reserves are subject to the risk of retrospective changes in judicial conditions such as the change in the Ogden discount rate announced on 27 February 2017. This is the discount rate set by the Lord Chancellor and used by courts to calculate lump sum awards in bodily injury cases. The rate had been 2.5% since 2001 but was changed to minus 0.75% from 20 March 2017. The Group revised its reserve estimation to be based on the new rate for year ended 31 December 2016. However, this rate is expected to change again in 2019 following the passing of the Civil Liability Act 2018. In anticipation of change, the Group has revalued its reserves based on an assumed Ogden discount rate of 0% for the year ended 31 December 2018. The new Ogden discount rate may differ from this assumption, and consequently further reserve revaluation may be required, both in 2019 and going forwards as part of the new Ogden discount rate review process introduced by the Civil Liability Act.

Uncertainty in claims reserves estimation is larger for claims such as PPOs for which annually indexed payments are made, typically over the lifetime of the injured party. Claims reserves for PPOs are held on a discounted basis and are sensitive to a change in the discount rate.

The table below provides a sensitivity analysis of the potential net impact of a change in a single factor (discount rate used for PPOs and separately the Ogden discount rate) with all other assumptions left unchanged. Other potential risks beyond the ones described could have an additional financial impact on the Group.

At 31 December	Increase / (decrease) in profit before tax[1,2] 2018 £m	2017 £m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	50.7	54.6
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(70.1)	(75.1)
Ogden discount rate[4]		
Impact of the Group reserving at a discount rate of 1% compared to 0% (2017: 0% compared to minus 0.75%)	56.2	68.4
Impact of the Group reserving at a discount rate of minus 1% compared to 0% (2017: minus 1.5% compared to minus 0.75%)	(76.3)	(102.9)

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated on the direct impact on the change in the real discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated on the direct impact of a permanent change in the discount rate with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis, as is the case at the year ended 31 December 2018. This is intended to ensure that reserves are appropriate for current and potential future developments.

The sensitivity above is calculated on the basis of a permanent change in the rate used for the actuarial best estimate reserves as at 31 December 2018. It does not take into account a change in the Ogden discount rate setting regime, nor any second order impacts such as those on the Group's PPO assumptions or reinsurance bad debt assumptions.

The reduction in sensitivity to a change in the Ogden discount rate since 31 December 2017 primarily reflects the overall reduction in bodily injury exposures. The reduction in exposure is due to continued positive prior-year development of claims reserves for large bodily injury claims, particularly for accident years where the reinsurance retention level was higher than the current level of £1.0 million.

There is the risk that claims are reserved or paid inappropriately, including the timing of such activity. However, there are claims management controls in place to mitigate this risk, as outlined below:

– claims are managed utilising a range of IT system-driven controls coupled with manual processes outlined in detailed policies and procedures to ensure claims are handled in an appropriate, timely and accurate manner;
– each member of staff has a specified handling authority, with controls preventing them handling or paying claims outside their authority, as well as controls to mitigate the risk of paying invalid claims. In addition, there are various outsourced claims handling arrangements, all of which are monitored closely by management, with similar principles applying in terms of the controls and procedures;
– loss adjustors are used in certain circumstances to handle claims to conclusion. This involves liaison with the policyholder, third parties, suppliers and the claims function;
– specialist bodily injury claims teams are responsible for handling these types of losses with the nature of handling dependent on the level and type of claim. Claims exceeding a certain threshold are referred to the technical and large loss teams who also deal with all other claim types above defined limits or within specific criteria; and
– a process is in place to deal with major weather and other catastrophic events, known as the 'Surge Demand Plan'. A surge is the collective name given to an incident which significantly increases the volume of claims reported to the Group's claims functions. The plan covers surge demand triggers, stages of incident, operational impact, communication and management information monitoring of the plan.

Underwriting risk
This is the risk that future claims experience on business written is materially different from the results expected, resulting in current-year losses. The Group predominantly underwrites personal lines insurance including motor, residential property, roadside assistance, creditor, travel and pet business. The Group also underwrites commercial risks primarily for low-to-medium risk trades within the small and medium-sized enterprises market. Contracts are typically issued on an annual basis which means that the Group's liability usually extends for a 12-month period, after which the Group is entitled to decline to renew or can revise renewal terms by amending the premium or other policy terms and conditions such as the excess as appropriate.

Underwriting risk includes catastrophe risk and the risk of loss, or of adverse change in the value of the insurance liabilities resulting from significant uncertainty of pricing, underwriting and provisioning assumptions related to extreme or exceptional circumstances.

3. Risk management continued

When underwriting policies, the Group is subject to concentration risk in a variety of forms, including:

- geographic concentration risk – the Group purchases a catastrophe reinsurance programme to protect against a modelled 1 in 200-years catastrophe loss. The programme is structured with the retention and limits expressed as percentages of gross earned premium. At 31 December 2018 this was the equivalent of £969.0 million (114% of gross earned premium of the previous 12 months) in excess of a retained deductible of £126.5 million (14.9% of gross earned premium);
- product concentration risk – the Group's business is heavily concentrated in the UK general insurance market. However, the Group offers a diversified portfolio of products and a variety of brands sold through a range of distribution channels to its customers; and
- sector concentration risk – the concentration of the Group to any given industry sector is monitored and analysed in respect of commercial customers.

It is important to note that none of these risk categories is independent of the others and that giving due consideration to the relationship between these risks is an important aspect of the effective management of insurance risk.

Distribution risk
This is the risk that material change in the volume of policies written may result in losses or reduced profitability.

Pricing risk
This is the risk of economic loss arising from policies being incorrectly priced or accepted to achieve desired volume and profitability.

Reinsurance risk
This is the risk of inappropriate selection and/or placement of reinsurance arrangements, with either individual or multiple reinsurers, which renders the transfer of insurance risk to the reinsurer(s) inappropriate and/or ineffective. Other risks include:

- reinsurance concentration risk – the concentration of credit exposure to any given counterparty;
- reinsurance capacity being reduced and/or withdrawn;
- underwriting risk appetite and reinsurance contract terms not being aligned;
- reinsurance contract terms being inappropriate or ineffective resulting in classes or types of business not being appropriately reinsured;
- non-adherence to the reinsurance policy terms and conditions, in terms of both policy management and claims not being handled within the reinsurance contract terms and conditions or paid on an ex-gratia basis resulting in reinsurance recoveries not being made in full;
- inappropriate or inaccurate management information and/or modelling being used to determine the value for money and purchasing of reinsurance (including aggregate modelling); and
- changes in the external legal, regulatory, social or economic environment altering the definition and application of reinsurance policy wordings or the effectiveness or value for money of reinsurance.

The Group uses reinsurance to:

- protect the underwriting result against low-frequency, high-severity losses through the transfer of catastrophe claims volatility to reinsurers;
- protect the underwriting result against unforeseen volumes of, or adverse trends in, large individual claims in order to reduce volatility and to improve stability of earnings;
- reduce the Group's capital requirements; and/or
- transfer risk that is not within the Group's current risk appetite.

3.3.2 Market risk

Market risk is the risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.

The Group is mainly exposed to the following market risk factors:

- spread risk;
- interest rate risk;
- property risk; and
- currency risk.

The Group has policies and limits approved by the Investment Committee for managing the market risk exposure. These set out the principles that the business should adhere to for managing market risk and establishing the maximum limits the Group is willing to accept having considered strategy, risk appetite and capital resources.

The Group monitors its market risk exposure on a monthly basis and, in addition, has established an aggregate exposure limit consistent with its risk objective to maintain capital adequacy. Interdependencies across risk types have also been considered within the aggregate exposure limit. The allocation of the Group's investments across asset classes has been approved by the Investment Committee.

The strategic asset allocation within the investment portfolio is reviewed by the Investment Committee, which makes recommendations to the Board for its investment strategy approval. The Investment Committee determines policy and controls, covering such areas as risk, liquidity and performance. The Investment Committee meets at least three times a year to evaluate risk exposure, the current strategy, associated policies and investment guidelines and to consider investment recommendations submitted to it. Oversight of the implementation of decisions taken by the Investment Committee is via the First and Second Lines of Defence.

The investment management objectives are to:

– maintain the safety of the portfolio's principal both in economic terms and from a capital, accounting and reporting perspective;
– maintain sufficient liquidity to provide cash requirements for operations, including in the event of a catastrophe; and
– maximise the portfolio's total return within the constraints of the other objectives and the limits defined by the investment guidelines and capital allocation.

The Group has a property portfolio and an infrastructure debt portfolio to generate a real return which, from an asset liability matching perspective, is used to offset the liability arising from longer duration PPOs.

The Group uses its internal economic capital model to determine its capital requirements and market risk limits and monitors its market risk exposure based on a 99.5% value-at-risk measure. The Group also applies market risk stressed scenarios testing for the economic impact of specific severe market conditions. The results of this analysis are used to enhance the understanding of market risk. The asset liability matching, and investment management minimum standard explicitly prohibits the use of derivatives for speculative or gearing purposes. However, the Group is able to and does use derivatives for hedging its currency risk and interest rate risk exposures.

Spread risk
This is the risk of loss from the sensitivity of the value of assets and investments to changes in the level or in the volatility of credit spreads over the risk-free interest rate term structure. The level of spread is the difference between the risk-free rate and actual rate paid on the asset, with larger spreads being associated with higher risk assets. The Group is exposed to spread risk through its asset portfolio, most notably through its investment in corporate bonds.

Interest rate risk
This is the risk of loss from all assets and liabilities for which the net asset value is sensitive to changes in the term structure of interest rates or interest rate volatility. The Group's interest rate risk arises mainly from its debt, floating interest rate investments and assets and liabilities exposed to fixed interest rates.

The Group has subordinated guaranteed dated notes with fixed coupon rates with a nominal value of £250 million. £500 million were issued on 27 April 2012; at the same time the Group entered into a 10-year designated hedging instrument, to exchange the fixed rate of interest on these notes to a floating rate, to hedge exposure to interest rate risk and have a redemption date of 27 April 2042. £250 million was repurchased by the Group on 8 December 2017.

The Group also has perpetual Tier 1 notes with fixed coupon rates with a nominal value of £350 million that were issued on 7 December 2017.

The Group also invests in floating rate debt securities, whose investment income is influenced by the movement of the short-term interest rate. A movement of the short-term interest rate will affect the expected return on these investments.

The market value of the Group's financial investments with fixed coupons is affected by the movement of interest rates. For the majority of investments in US Dollar corporate bonds, excluding £405.2 million of short duration high yield bonds (2017: £403.9 million), the Group hedges the exposure of this portfolio to the US Dollar interest rate risk using swaps.

Property risk
This is the risk of loss arising from sensitivity of assets and financial investments to the level or volatility of market prices, rental yields, or occupancy rates of properties. At 31 December 2018, the value of these property investments was £322.1 million (2017: £309.3 million). The property investments are located in the UK.

3. Risk management continued

Currency risk
This is the risk of loss from changes in the level or volatility of currency exchange rates.

Exposure to currency risk is generated by the Group's investments in US Dollar and Euro denominated corporate bonds.

The Group maintains exposure to US Dollar securities through £1,699.3 million (2017: £2,084.5 million) of investments in US Dollar corporate bonds and Euro securities through £79.4 million (2017: £110.4 million) of Euro corporate bonds. The foreign currency exposure of these investments is hedged by foreign currency forward contracts, maintaining a minimal unhedged currency exposure on these portfolios, as well as a low basis risk on the hedging contracts.

A limited exposure to currency risk also arises through the Group's insurance and other contractual liabilities.

Currency risk is not material at Group level.

Use of derivatives
As mentioned above, the Group uses derivatives to hedge against interest rate and currency risk.

The tables below analyse the maturity of the Group's derivative assets and liabilities.

	Notional amounts	Maturity and fair value			
At 31 December 2018	**£m**	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	**Total £m**
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**1,354.6**	19.2	–	–	**19.2**
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	**18.5**	1.2	0.2	–	**1.4**
Interest rate swaps	**1,198.3**	(2.7)	15.9	14.4	**27.6**
Total	**2,571.4**	**17.7**	**16.1**	**14.4**	**48.2**

	Notional amounts	Maturity and fair value			
At 31 December 2018	**£m**	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	**Total £m**
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**1,716.2**	20.6	–	–	**20.6**
Designated as hedging instruments:					
Interest rate swaps	**341.2**	0.4	0.4	4.5	**5.3**
Total	**2,057.4**	**21.0**	**0.4**	**4.5**	**25.9**

	Notional amounts	Maturity and fair value			
At 31 December 2017	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	2,735.3	51.1	–	–	51.1
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	17.3	1.0	–	–	1.0
Interest rate swaps	1,794.9	(1.9)	21.5	12.7	32.3
Total	4,547.5	50.2	21.5	12.7	84.4

	Notional amounts	Maturity and fair value			
At 31 December 2017	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	579.9	11.3	–	–	11.3
Designated as hedging instruments:					
Interest rate swaps	113.1	0.5	(0.1)	0.3	0.7
Total	693.0	11.8	(0.1)	0.3	12.0

Sensitivity analysis

The table below provides a sensitivity analysis of the potential impact on financial investments and derivatives of a change in a single factor with all other assumptions left unchanged. Other potential risks beyond the ones described in the table could have an additional financial impact on the Group.

	Increase / (decrease) in profit before tax[1]		Decrease in total equity[1] at 31 December	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Spread				
Impact of a 100 basis points increase in spreads on financial investments[2,3,5]	**–**	–	**(171.1)**	(183.5)
Interest rate				
Impact of a 100 basis points increase in interest rates on financial investments and derivatives[2,3,4,5]	**15.6**	17.3	**(101.1)**	(98.3)
Investment property				
Impact of a 15% decrease in property markets	**(48.3)**	(46.4)	**(48.3)**	(46.4)

Notes:

1. These sensitivities exclude the impact of taxation.
2. The income statement impact on financial investments is limited to floating rate instruments and interest rate derivatives used to hedge a portion of the portfolio. The income statement is not impacted in relation to fixed rate instruments, in particular AFS debt securities, where the coupon return is not impacted by a change in prevailing market rates, as the accounting treatment for AFS debt securities means that only the coupon received is processed through the income statement with fair value movements being recognised through total equity.
3. The increase or decrease in total equity does not reflect any fair value movement in infrastructure debt, HTM debt securities and commercial real estate loans that would not be recorded in the financial statements under IFRSs as they are classified as loans and receivables and HTM respectively, which are carried at amortised cost. It is estimated that a fair value reduction in these asset categories resulting from a 100 basis points increase in spreads would have been £22.2 million (2017: £23.7 million) and a 100 basis points increase in interest rate would have been £5.8 million (2017: £6.2 million).
4. The sensitivities set out above reflect one-off impacts at 31 December with the exception of the income statement interest rate sensitivity on financial investments and derivatives, which projects a movement in a full year's interest charge as a result of the increase in the interest rate applied to these assets or liabilities on those positions held at 31 December.
5. The subordinated liabilities and associated interest rate swap are excluded from the sensitivity analysis.
6. The sensitivities set out above have not considered the impact of the general market changes on the value of the Group's insurance liabilities or retirement benefit obligations. They reflect one-off impacts at 31 December and should not be interpreted as predictions.

The Group has a number of open interest rate and foreign exchange derivative positions. Collateral management arrangements are in place for significant counterparty exposures. At 31 December 2018, the Group has pledged £31.8 million in cash (2017: £28.2 million) and £2.9 million in UK Gilts (2017: £0.3 million) to cover initial margins and out-of-the-money derivative positions. At 31 December 2018, counterparties have pledged £24.0 million in cash and £7.6 million in UK Gilts (2017: £25.1 million in cash and £15.5 million in UK Gilts) to the Group to cover in-the-money derivative positions.

The terms and conditions of collateral pledged for both assets and liabilities are market standard. When securities are pledged they are required to be readily convertible to cash, and as such no policy has been established for the disposal of assets not readily convertible into cash.

3.3.3 Credit risk

This is the risk of loss resulting from default in cash inflows and/or changes in market value of issuers of securities, counterparties and any debtors to which the Group is exposed. The Group is mainly exposed to the following credit risk factors:

– counterparty default risk; and

– concentration risk.

Counterparty default risk

This is the risk of loss from unexpected default of the counterparties and debtors of Group undertakings. This risk is monitored by three forums: the Investment risk forum monitors credit spreads as indicators of potential losses on investments incurred but not yet realised; the Credit risk forum monitors reinsurance and corporate insurance counterparty default risk; and the NIG credit committee is responsible for monitoring broker credit risk. The main responsibility of these forums is to ensure that all material aspects of counterparty default risk within the Group are identified, monitored and measured.

The main sources of counterparty default risk for the Group are:

– investments – this arises from the investment of funds in a range of investment vehicles permitted by the investment policy;

– reinsurance recoveries – counterparty exposure to reinsurance counterparties arises in respect of reinsurance claims against which a reinsurance bad debt provision is assessed. PPOs have the potential to increase the ultimate value of a claim and, by their very nature, to increase significantly the length of time to reach final payment. This can increase reinsurance counterparty default risk in terms of both amount and longevity; and

– consumer credit – exposure from offering monthly instalments on annual insurance contracts.

3. Risk management continued

The Group cedes insurance risk to reinsurers but, in return, assumes counterparty default risk against which a reinsurance bad debt provision is assessed. The financial security of the Group's panel of reinsurers is therefore important and both the quality and amount of the assumed counterparty default risk are subject to an approval process whereby reinsurance is only purchased from reinsurers that hold a credit rating of at least A– at the time cover is purchased. The Group's leading counterparty exposures are reviewed on a quarterly basis by the Head of Reinsurance and Corporate Insurance. The Group aims to contract with a diverse range of reinsurers on its contracts to mitigate the credit and/or non-payment risks associated with its reinsurance exposures.

Certain reinsurance contracts have long durations as a result of bodily injury and PPO claims, and insurance reserves therefore include provisions beyond the levels created for shorter-term reinsurance bad debt. For these contracts, reinsurance is only purchased from reinsurers that hold a credit rating of at least A+ at the time cover is purchased.

The following tables analyse the carrying value of financial and insurance assets that bear counterparty default risk between those assets that have not been impaired by age in relation to due date, and those that have been impaired.

At 31 December 2018	**Neither past due nor impaired £m**	Past due 1 – 90 days £m	Past due more than 90 days £m	Assets that have been impaired £m	**Carrying value in the balance sheet £m**
Reinsurance assets	**1,208.7**	–	–	–	**1,208.7**
Insurance and other receivables	**836.0**	39.6	0.3	–	**875.9**
Derivative assets	**48.2**	–	–	–	**48.2**
Debt securities	**4,246.6**	–	–	–	**4,246.6**
Infrastructure debt	**289.6**	–	–	–	**289.6**
Commercial real estate loans	**201.6**	–	–	–	**201.6**
Cash and cash equivalents[1]	**1,154.4**	–	–	–	**1,154.4**
Total	**7,985.1**	**39.6**	**0.3**	**–**	**8,025.0**

At 31 December 2017	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 90 days £m	Assets that have been impaired £m	Carrying value in the balance sheet £m
Reinsurance assets	1,178.5	–	–	–	1,178.5
Insurance and other receivables	942.5	38.2	0.5	–	981.2
Derivative assets	84.4	–	–	–	84.4
Debt securities	4,555.0	–	–	–	4,555.0
Infrastructure debt	316.4	–	–	–	316.4
Commercial real estate loans	169.0	–	–	–	169.0
Cash and cash equivalents[1]	1,358.6	–	–	–	1,358.6
Total	8,604.4	38.2	0.5	–	8,643.1

Note:

1. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

Within the analysis of debt securities above are bank debt securities at 31 December 2018 of £1,125.2 million (2017: £1,197.4 million), that can be further analysed as: secured £63.0 million (2017: £63.5 million); unsecured £949.8 million (2017: £976.3 million); and subordinated £112.4 million (2017: £157.6 million).

Concentration risk

This is the risk of loss associated with inadequately diversified portfolios of assets and/or obligations, in particular:

– large exposures to individual credits (either bond issuers or deposit-taking institutions); and

– large exposures to different credits where movements in values and ratings are closely correlated.

Concentration risk on investments arises through excessive exposure to particular industry sectors, groups of business undertakings or similar activities. The Group may suffer significant losses in its investment portfolio as a result of over exposure to particular sectors engaged in similar activities or similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

The table below analyses the distribution of debt securities by geographical area (commercial real estate loans and infrastructure debt are all within the UK).

At 31 December 2018	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
Australia	169.5	–	–	–	169.5
Austria	11.3	–	–	–	11.3
Belgium	37.2	–	–	–	37.2
Bermuda	1.5	–	–	–	1.5
Canada	72.7	–	–	–	72.7
Cayman Islands	5.7	–	–	–	5.7
Denmark	12.0	–	–	–	12.0
Finland	22.5	12.0	–	–	34.5
France	217.1	7.5	–	–	224.6
Germany	200.5	–	–	–	200.5
Hong Kong	6.3	–	–	–	6.3
Ireland	13.8	–	–	–	13.8
Italy	38.7	–	–	–	38.7
Japan	33.9	–	–	–	33.9
Luxembourg	2.6	–	–	–	2.6
Mexico	14.3	–	–	–	14.3
Netherlands	139.9	–	–	–	139.9
New Zealand	27.0	–	–	–	27.0
Norway	15.8	10.0	–	–	25.8
Spain	35.2	–	–	–	35.2
Sweden	85.4	–	–	–	85.4
Switzerland	64.5	–	–	–	64.5
UK	1,081.6	–	156.9	–	1,238.5
USA	1,708.0	–	–	–	1,708.0
Supranational	–	–	–	43.2	43.2
Total	**4,017.0**	**29.5**	**156.9**	**43.2**	**4,246.6**

3. Risk management continued

The table below analyses the distribution of debt securities by geographical area (commercial real estate loans and infrastructure debt are all within the UK).

At 31 December 2017	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
Australia	101.7	–	–	–	101.7
Austria	1.8	–	–	–	1.8
Belgium	39.6	–	9.5	–	49.1
Bermuda	6.4	–	–	–	6.4
Canada	35.6	–	–	–	35.6
Cayman Islands	16.8	–	–	–	16.8
Denmark	18.2	–	–	–	18.2
France	216.3	3.6	–	–	219.9
Germany	231.9	–	–	–	231.9
Hong Kong	3.9	–	–	–	3.9
Ireland	9.9	–	–	–	9.9
Italy	23.1	–	–	–	23.1
Japan	53.0	–	–	–	53.0
Luxembourg	4.5	–	–	–	4.5
Mexico	10.6	–	–	–	10.6
Netherlands	166.6	–	–	–	166.6
New Zealand	18.1	–	–	–	18.1
Norway	27.1	–	–	–	27.1
Singapore	25.0	–	–	–	25.0
South Korea	3.8	–	–	–	3.8
Spain	42.1	–	–	–	42.1
Sweden	80.6	8.6	–	–	89.2
Switzerland	104.5	–	–	–	104.5
UK	1,113.2	–	215.3	–	1,328.5
USA	1,919.8	–	–	–	1,919.8
Supranational	–	–	–	43.9	43.9
Total	4,274.1	12.2	224.8	43.9	4,555.0

The table below analyses the distribution of debt securities by industry sector classifications.

At 31 December	2018 £m	2018 %	2017 £m	2017 %
Basic materials	**104.4**	**2%**	110.3	3%
Communications	**241.9**	**6%**	239.2	5%
Consumer, cyclical	**312.8**	**8%**	374.9	8%
Consumer, non-cyclical	**449.8**	**11%**	494.4	11%
Diversified	**51.8**	**1%**	57.9	1%
Energy	**206.9**	**5%**	263.6	6%
Financial	**1,817.6**	**43%**	1,836.1	40%
Industrial	**233.3**	**5%**	216.2	5%
Sovereign, supranational and local government	**229.6**	**5%**	280.9	6%
Technology	**115.5**	**3%**	163.1	4%
Transport	**13.4**	**0%**	13.4	0%
Utilities	**469.6**	**11%**	505.0	11%
Total	**4,246.6**	**100%**	4,555.0	100%

The table below analyses the distribution of infrastructure debt by industry sector classifications.

At 31 December	2018 £m	2018 %	2017 £m	2017 %
Social, of which:				
Education	125.8	44%	140.5	44%
Healthcare	76.0	26%	84.3	27%
Other	54.9	19%	56.3	18%
Transport	32.9	11%	35.3	11%
Total	289.6	100%	316.4	100%

The tables below analyse the credit quality of debt securities that are neither past due nor impaired.

At 31 December 2018	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Total £m
Corporate	145.8	549.3	1,785.0	1,143.0	393.9	4,017.0
Supranational	38.7	4.5	–	–	–	43.2
Local government	10.0	19.5	–	–	–	29.5
Sovereign	–	156.9	–	–	–	156.9
Total	194.5	730.2	1,785.0	1,143.0	393.9	4,246.6

At 31 December 2017	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Total £m
Corporate	183.1	412.0	2,145.8	1,144.6	388.6	4,274.1
Supranational	39.3	4.6	–	–	–	43.9
Local government	–	12.2	–	–	–	12.2
Sovereign	–	224.8	–	–	–	224.8
Total	222.4	653.6	2,145.8	1,144.6	388.6	4,555.0

The tables below analyse the credit quality of financial and insurance assets that are neither past due nor impaired (excluding debt securities analysed above). The tables include reinsurance exposure, after provision. The Group's approach to reinsurance counterparty default risk is detailed on page 151.

At 31 December 2018	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Not rated £m	Total £m
Reinsurance assets	–	837.4	366.9	3.0	–	1.4	1,208.7
Insurance and other receivables[1]	–	7.0	15.7	16.1	–	797.2	836.0
Derivative assets	–	15.5	22.6	10.1	–	–	48.2
Infrastructure debt	–	–	78.7	210.9	–	–	289.6
Commercial real estate loans	–	58.6	117.2	25.8	–	–	201.6
Cash and cash equivalents[2]	997.0	39.6	59.1	58.7	–	–	1,154.4
Total	997.0	958.1	660.2	324.6	–	798.6	3,738.5

At 31 December 2017	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Not rated £m	Total £m
Reinsurance assets	–	823.2	349.5	1.0	–	4.8	1,178.5
Insurance and other receivables[1]	–	24.7	15.1	10.0	–	892.7	942.5
Derivative assets	–	34.5	33.4	16.5	–	–	84.4
Infrastructure debt	–	–	81.2	229.2	6.0	–	316.4
Commercial real estate loans	13.8	34.8	101.1	19.3	–	–	169.0
Cash and cash equivalents[2]	1,100.6	134.6	46.8	76.6	–	–	1,358.6
Total	1,114.4	1,051.8	627.1	352.6	6.0	897.5	4,049.4

Notes:
1. Includes receivables due from policyholders, agents, brokers and intermediaries which generally do not have a credit rating.
2. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

3. Risk management continued

3.3.4 Operational risk

This is the risk of loss due to inadequate or failed internal processes, people, systems, or from external events. Material sources of operational risk for the Group include:

Change risk
This is the risk of failing to manage the Group's change portfolio resulting in conflicting priorities and failure to deliver strategic outcomes to time, cost or quality.

Technology and infrastructure risk
This is the risk that the IT infrastructure is insufficient to deliver the Group's strategy.

Outsourcing risk
This is the risk of failing to implement a robust framework for the sourcing, appointment and ongoing contract management of third party suppliers, outsourced service providers and intragroup relationships. This includes both domestic and offshore outsourcing activities.

Information security risk
This is the risk of loss, corruption to Group or customer data, intellectual property or failure of business-critical systems resulting in reputational damage, regulatory censure, supervision, fines and/or loss of competitive advantage.

Partnership contractual obligations
This is the risk of contractual obligations not being delivered for business partners resulting in damaged reputation, the loss of contract at renewal, significant liability payments and/or the early termination of a partnership scheme.

The Group has in place agreed policies and standards to establish key controls relating to operational risk.

3.3.5 Liquidity risk

This is the risk of being unable to realise investments in order to settle financial obligations when they fall due.

The measurement and management of liquidity risk within the Group is undertaken within the limits and other policy parameters of the Group's liquidity risk appetite and is detailed within the liquidity risk minimum standard. As part of this process the Investment and Treasury team are required to put in place a liquidity plan which must consider expected and stressed scenarios for cash in-flows and out-flows that is reviewed at least annually by the Investment Risk Committee. Compliance is monitored in respect of both the minimum standard and the regulatory requirements of the PRA.

The following table analyses the carrying value of financial investments and cash and cash equivalents, by contractual maturity, which are able to fund the repayment of liabilities as they crystallise.

At 31 December 2018	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**
Debt securities	411.5	907.1	1,153.4	1,612.3	162.3	**4,246.6**
Infrastructure debt	13.3	27.0	31.3	94.2	123.8	**289.6**
Commercial real estate loans	18.2	74.6	108.8	–	–	**201.6**
Cash and cash equivalents[1]	1,154.4	–	–	–	–	**1,154.4**
Total	**1,597.4**	**1,008.7**	**1,293.5**	**1,706.5**	**286.1**	**5,892.2**

At 31 December 2017	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m
Debt securities	492.5	1,017.9	1,109.5	1,710.2	224.9	4,555.0
Infrastructure debt	13.0	30.9	29.8	94.4	148.3	316.4
Commercial real estate loans	4.3	56.6	108.1	–	–	169.0
Cash and cash equivalents[1]	1,358.6	–	–	–	–	1,358.6
Total	1,868.4	1,105.4	1,247.4	1,804.6	373.2	6,399.0

Note:
1. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

The following table analyses the undiscounted cash flows of insurance and financial liabilities by contractual repricing or maturity dates, whichever is earlier.

At 31 December 2018	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**	Carrying value £m
Subordinated liabilities	23.1	46.3	261.6	–	–	**331.0**	259.5
Insurance liabilities[1]	1,175.0	1,025.1	547.1	452.9	2,299.9	**5,500.0**	4,005.9
Borrowings	62.0	–	–	–	–	**62.0**	62.0
Trade and other payables, including insurance payables	547.6	5.2	0.7	0.6	–	**554.1**	554.1
Total	**1,807.7**	**1,076.6**	**809.4**	**453.5**	**2,299.9**	**6,447.1**	**4,881.5**

At 31 December 2017	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m	Carrying value £m
Subordinated liabilities	23.1	46.3	284.7	–	–	354.1	264.7
Insurance liabilities[1]	1,144.6	1,035.0	560.4	573.3	2,448.7	5,762.0	4,225.7
Borrowings	54.1	–	–	–	–	54.1	54.1
Trade and other payables, including insurance payables	648.8	8.0	0.4	0.8	–	658.0	658.0
Total	1,870.6	1,089.3	845.5	574.1	2,448.7	6,828.2	5,202.5

Note:

1. Insurance liabilities exclude unearned premium reserves as there are no liquidity risks inherent in them.

3.4 Capital management

The Group manages capital in accordance with the Group's capital management minimum standard, the aims of which are to manage capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, credit rating agency and policyholder requirements. The Group seeks to hold capital resources such that, in normal circumstances, the solvency capital ratio is around the middle of the target range of 140% to 180%.

The Group's regulatory capital position is assessed against the solvency II framework. From 1 July 2016, the Group gained approval to assess its SCR using a partial internal model, including a full internal economic capital model for the UKI underwriting entity. The model is calibrated to a 99.5% confidence interval and considers business written to date and one year of future written business over a one-year time horizon, in line with solvency II requirements.

3.5 Capital adequacy (unaudited)

Using the Group's partial internal model, there is a capital surplus of approximately £0.89 billion above an estimated SCR of £1.26 billion as at 31 December 2018 (31 December 2017: £0.91 billion and £1.39 billion respectively). The Group's capital requirements and solvency position are produced and presented to the Board on a regular basis.

4. Segmental analysis

The Directors manage the Group primarily by product type and present the segmental analysis on that basis. The segments, which are all UK based, reflect the management structure whereby a member of the Executive Committee is accountable to the Chief Executive Officer for each of the operating segments:

Motor

This segment consists of personal motor insurance together with the associated legal protection cover. The Group sells motor insurance direct to customers through its own brands Direct Line, Churchill and Privilege, and through partnership brands such as vehicle manufacturers and through price comparison websites. The Motor segment includes results previously reported in the Run-off and restructuring segments. Comparative data has been re-presented accordingly.

Home

This segment consists of home insurance together with associated legal protection cover. The Group sells home insurance products through our brands Direct Line, Churchill and Privilege, and our partnership brands (RBS, NatWest and Prudential), as well as through price comparison websites.

Rescue and other personal lines

This segment consists of rescue products which are sold direct through the Group's own brand, Green Flag, and other personal lines insurance, including travel, pet and creditor sold through its own brands Direct Line, Churchill and Privilege, and through partnership brands and through price comparison websites.

Commercial

This segment consists of commercial insurance for small and medium-sized enterprises sold through our brands NIG, Direct Line for Business and Churchill. NIG sells its products exclusively through brokers operating across the UK. Direct Line for Business sells its products directly to customers, and Churchill sells its products directly to customers and through price comparison websites.

4. Segmental analysis continued

No inter-segment transactions occurred in the year ended 31 December 2018 (2017: £nil). If any transaction were to occur, transfer prices between operating segments would be set on an arm's length basis in a manner similar to transactions with third parties. Segment income, expenses and results will include those transfers between business segments which will then be eliminated on consolidation.

For each operating segment, there is no individual policyholder or customer that represents 10% or more of the Group's total revenue.

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2018.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	**Total Group £m**
Gross written premium	1,671.2	606.9	422.8	511.0	**3,211.9**
Gross earned premium	1,684.3	698.0	416.6	507.8	**3,306.7**
Reinsurance premium	(142.5)	(30.2)	(1.9)	(42.6)	**(217.2)**
Net earned premium	1,541.8	667.8	414.7	465.2	**3,089.5**
Investment return	105.9	15.9	5.2	27.6	**154.6**
Instalment income	89.2	21.9	2.5	6.3	**119.9**
Other operating income	48.3	2.7	15.8	5.3	**72.1**
Total income	1,785.2	708.3	438.2	504.4	**3,436.1**
Insurance claims	(1,026.7)	(421.0)	(277.1)	(242.1)	**(1,966.9)**
Insurance claims recoverable from / (payable to) reinsurers	46.7	7.7	(0.1)	0.8	**55.1**
Net insurance claims	(980.0)	(413.3)	(277.2)	(241.3)	**(1,911.8)**
Commission expenses	(30.9)	(62.6)	(19.0)	(87.9)	**(200.4)**
Operating expenses	(359.1)	(149.3)	(98.6)	(115.2)	**(722.2)**
Total expenses	(390.0)	(211.9)	(117.6)	(203.1)	**(922.6)**
Operating profit	**415.2**	**83.1**	**43.4**	**60.0**	**601.7**
Finance costs					**(19.1)**
Profit before tax					**582.6**

Underwriting profit	**171.8**	**42.6**	**19.9**	**20.8**	**255.1**
Loss ratio	63.6%	61.8%	66.8%	51.8%	**61.8%**
Commission ratio	2.0%	9.4%	4.6%	18.9%	**6.5%**
Expense ratio	23.3%	22.4%	23.8%	24.8%	**23.4%**
COR	**88.9%**	**93.6%**	**95.2%**	**95.5%**	**91.7%**

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including the restructuring costs and Run-off segment.

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2018.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	**Total £m**
Goodwill	128.1	45.8	28.7	10.1	**212.7**
Other segment assets	6,755.0	788.1	210.3	1,420.0	**9,173.4**
Segment liabilities	(4,775.7)	(551.0)	(147.0)	(992.8)	**(6,466.5)**
Segment net assets	**2,107.4**	**282.9**	**92.0**	**437.3**	**2,919.6**

The segmental analysis of assets and liabilities is prepared using a combination of asset and liability balances directly attributable to each operating segment and an apportionment of assets and liabilities managed at a Group wide level. This does not represent the Group's view of the capital requirements for its operating segments.

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2017.

	Motor[1] £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,670.4	799.1	421.1	501.5	3,392.1
Gross earned premium	1,603.0	819.4	419.2	498.1	3,339.7
Reinsurance premium	(132.4)	(28.9)	(1.6)	(41.8)	(204.7)
Net earned premium	1,470.6	790.5	417.6	456.3	3,135.0
Investment return	117.9	21.1	4.6	31.8	175.4
Instalment income	85.3	23.1	2.1	5.9	116.4
Other operating income	43.0	0.9	12.9	6.1	62.9
Total income	1,716.8	835.6	437.2	500.1	3,489.7
Insurance claims	(717.1)	(403.3)	(273.8)	(176.9)	(1,571.1)
Insurance claims (payable to) / recoverable from reinsurers	(135.8)	2.8	0.5	(50.6)	(183.1)
Net insurance claims	(852.9)	(400.5)	(273.3)	(227.5)	(1,754.2)
Commission expenses	(36.7)	(139.7)	(22.9)	(87.1)	(286.4)
Operating expenses	(430.8)	(166.6)	(97.4)	(111.5)	(806.3)
Total expenses	(467.5)	(306.3)	(120.3)	(198.6)	(1,092.7)
Operating profit	396.4	128.8	43.6	74.0	642.8
Finance costs					(103.8)
Profit before tax					539.0

	Motor[1]	Home	Rescue and other personal lines	Commercial	Total Group
Underwriting profit	150.2	83.7	24.0	30.2	288.1
Loss ratio	58.0%	50.6%	65.4%	49.9%	56.0%
Commission ratio	2.5%	17.7%	5.5%	19.1%	9.1%
Expense ratio	29.3%	21.1%	23.4%	24.4%	25.7%
COR	89.8%	89.4%	94.3%	93.4%	90.8%

	Motor[2]	Total Ongoing[2]
Loss ratio	60.9%	57.4%
Commission ratio	2.5%	9.1%
Expense ratio	28.5%	25.3%
COR	91.9%	91.8%

Notes:

1. The Motor segment for the year ended 31 December 2017 includes restructuring costs and the Run-off segment, which were total income of £0.7 million, net insurance claims of £43.1 million and operating expenses of £11.9 million.
2. Comparative ratios for the Motor segment and total Ongoing operations, prior to re-presentation of the restructuring costs and the Run-off segment. Ongoing operations for 2017 comprised total Group operations less the restructuring costs and the Run-off segment.

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2017.

	Motor[1] £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total £m
Goodwill	127.7	45.8	28.7	10.1	212.3
Other segment assets	7,297.5	708.8	204.3	1,525.1	9,735.7
Segment liabilities	(5,177.4)	(496.8)	(143.2)	(1,069.0)	(6,886.4)
Segment net assets	2,247.8	257.8	89.8	466.2	3,061.6

Note:

1. The Motor segment for the year ended 31 December 2017 includes the Run-off segment, which comprised other segment assets of £642.7 million and other segment liabilities of £512.8 million.

The segmental analysis of assets and liabilities is prepared using a combination of asset and liability balances directly attributable to each operating segment and an apportionment of assets and liabilities managed at a Group-wide level. This does not represent the Group's view of the capital requirements for its operating segments.

5. Net earned premium

	2018 £m	2017 £m
Gross earned premium:		
Gross written premium	3,211.9	3,392.1
Movement in unearned premium reserve	94.8	(52.4)
	3,306.7	3,339.7
Reinsurance premium:		
Premium payable	(223.5)	(208.4)
Movement in reinsurance unearned premium reserve	6.3	3.7
	(217.2)	(204.7)
Total	3,089.5	3,135.0

6. Investment return

	2018 £m	2017 £m
Investment income:		
Interest income from debt securities	124.0	137.5
Interest income from cash and cash equivalents	6.2	3.0
Interest income from infrastructure debt	6.9	6.8
Interest income from commercial real estate loans	6.2	3.6
Interest income	143.3	150.9
Rental income from investment property	15.9	16.2
	159.2	167.1
Net realised (losses) / gains:		
AFS debt securities	19.5	23.2
Derivatives	(32.2)	175.0
Investment property (note 19)	–	1.6
	(12.7)	199.8
Net unrealised gains / (losses):		
Impairment of loans and receivables	(6.0)	(9.5)
Derivatives	1.4	(202.0)
Investment property (note 19)	12.7	20.0
	8.1	(191.5)
Total	154.6	175.4

The table below analyses the realised and unrealised gains and losses on derivative instruments included in investment return.

	Realised 2018 £m	Unrealised 2018 £m	Realised 2017 £m	Unrealised 2017 £m
Derivative (losses) / gains:				
Foreign exchange forward contracts[1]	(102.6)	(41.3)	107.8	62.5
Associated foreign exchange risk	72.6	41.3	68.4	(259.1)
Net (losses) / gains on foreign exchange forward contracts	(30.0)	–	176.2	(196.6)
Interest rate swaps[1]	22.1	(1.8)	1.8	(1.7)
Associated interest rate risk on hedged items	(24.3)	3.2	(3.0)	(3.7)
Net (losses) / gains on interest rate derivatives	(2.2)	1.4	(1.2)	(5.4)
Total	(32.2)	1.4	175.0	(202.0)

Note:
1. Foreign exchange forward contracts are measured at fair value through profit and loss and interest rate swaps are designated as hedging instruments.

7. Other operating income

	2018 £m	2017 £m
Vehicle replacement referral income	17.2	16.9
Revenue from vehicle recovery and repair services	11.7	11.3
Legal services income	11.2	11.0
Other income[1,2]	32.0	23.7
Total	72.1	62.9

Notes:
1. Other income includes salvage income and fee income from insurance intermediary services.
2. Other income includes a £9.6 million gain on the sale of a property in Bristol in January 2018.

8. Net insurance claims

	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	2018 £m	2018 £m	2018 £m	2017 £m	2017 £m	2017 £m
Current accident year claims paid	1,308.5	(0.2)	1,308.3	1,165.0	(0.2)	1,164.8
Prior accident year claims paid	878.2	(30.9)	847.3	847.0	(13.8)	833.2
(Decrease) / increase in insurance liabilities	(219.8)	(24.0)	(243.8)	(440.9)	197.1	(243.8)
Total	1,966.9	(55.1)	1,911.8	1,571.1	183.1	1,754.2

Claims handling expenses for the year ended 31 December 2018 of £192.9 million (2017[1]: £174.8 million) have been included in the claims figures above.

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including the Run-off segment. Comparative data has been re-presented accordingly.

9. Commission expenses

	2018 £m	2017 £m
Commission expenses	188.5	225.4
Expenses incurred under profit participations	11.9	61.0
Total	200.4	286.4

10. Operating expenses

	2018 £m	2017 £m
Staff costs[1]	269.9	280.1
Other operating expenses[1,2]	253.3	273.6
Marketing	121.2	113.7
Amortisation and impairment of other intangible assets[3]	46.7	111.0
Depreciation	31.1	27.9
Total	722.2	806.3

Notes:
1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. Other operating expenses include IT costs, insurance levies, professional fees and property costs.
3. Amortisation and impairment of other intangible assets includes a £1.5 million impairment charge for the year ended 31 December 2018 (2017: £56.9 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

The table below analyses the number of people employed by the Group's operations.

	At 31 December		Average for the year	
	2018	2017	2018	2017
Insurance operations	8,583	8,267	8,569	8,431
Repair centre operations	1,368	1,272	1,326	1,238
Support	1,278	1,269	1,266	1,280
Total	11,229	10,808	11,161	10,949

10. Operating expenses continued

The aggregate remuneration of those employed by the Group's operations comprised:

	2018 £m	2017 £m
Wages and salaries	374.9	363.6
Social security costs	41.2	40.4
Pension costs	28.7	25.5
Share-based payments	21.0	14.8
Total	465.8	444.3

The table below analyses Auditor's remuneration in respect of the Group's operations.

	2018 £m	2017 £m
Fees payable for the audit of:		
The Company's annual accounts	0.2	0.3
The Company's subsidiaries	1.7	1.6
Total audit fees	1.9	1.9
Audit-related assurance services	0.1	0.1
Other assurance services	0.1	–
Non-audit services	0.6	0.1
Total	2.7	2.1

Aggregate Directors' emoluments

The table below analyses the total amount of Directors' remuneration in accordance with Schedule 5 to the Accounting Regulations.

	2018 £m	2017 £m
Salaries, fees, bonuses and benefits in kind	5.9	5.6
Gains on exercise of share options	4.2	5.3
Total	10.1	10.9

Further information about the remuneration of individual Directors is provided in the Directors' remuneration report.

At 31 December 2018, no Directors (2017: no Directors) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service. During the year ended 31 December 2018, four Directors exercised share options (2017: three Directors).

11. Finance costs

	2018 £m	2017 £m
Interest expense on subordinated liabilities	23.1	44.8
Net interest received on designated hedging instrument[1]	(3.8)	(8.0)
Unrealised losses on designated hedging instrument[1]	5.0	10.4
Unrealised gains on associated interest rate risk on hedged item[1]	(5.6)	(11.7)
Realised gain on associated interest rate risk on hedged item[1]	–	(11.3)
Premium paid to repurchase subordinated liabilities and associated transaction costs	–	77.4
Amortisation of arrangement costs and discount on issue of subordinated liabilities	0.4	2.2
Total	19.1	103.8

Note:

1. As described in note 32, on 27 April 2012 the Group issued subordinated guaranteed dated notes with a nominal value of £500 million at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year designated hedging instrument to exchange the fixed rate of interest on the notes for a floating rate of 3-month LIBOR plus a spread of 706 basis points, which increased to 707 basis points with effect from 29 July 2013. On 8 December 2017, the Group redeemed £250 million nominal value of the notes.

12. Tax charge

	2018 £m	2017 £m
Current taxation:		
Charge for the year	114.4	114.4
(Over) / under provision in respect of prior year	(4.8)	5.3
	109.6	119.7
Deferred taxation (note 13):		
Credit for the year	(4.2)	(5.8)
Under / (over) provision in respect of prior year	3.5	(8.9)
	(0.7)	(14.7)
Current taxation	109.6	119.7
Deferred taxation (note 13)	(0.7)	(14.7)
Tax charge for the year	108.9	105.0

The following table analyses the difference between the actual income tax charge and the expected income tax charge computed by applying the standard rate of corporation tax of 19.0%[1] (2017: 19.25%).

	2018 £m	2017 £m
Profit before tax	582.6	539.0
Expected tax charge	110.7	103.8
Effects of:		
Disallowable expenses	5.4	5.4
Non-taxable items	(2.5)	(0.3)
Effect of change in corporation taxation rate	(0.2)	(0.2)
Over provision in respect of prior year	(1.3)	(3.7)
Deductible Tier 1 notes coupon payment in equity	(3.2)	–
Tax charge for the year	108.9	105.0
Effective income tax rate	18.7%	19.5%

Note:

1. In the Finance (No 2) Act 2015 the UK Government enacted a reduction in the UK corporation tax rate from 20% to 19% effective from 1 April 2017, and then the Finance Act 2016 enacted a further reduction to 17% effective from 1 April 2020. As a consequence, the closing deferred tax assets and liabilities have been recognised at the tax rates expected to apply when the assets or liabilities are settled. The impact of these changes on the tax charge for the year is set out in the table above.

13. Current and deferred tax

	2018 £m	2017 £m
Per balance sheet:		
Current tax assets	–	0.1
Current tax liabilities	(46.0)	(40.7)
Deferred tax liabilities	(7.6)	(31.1)

13. Current and deferred tax continued

The table below analyses the major deferred tax assets and liabilities recognised by the Group and movements thereon.

	Provisions and other temporary differences £m	Retirement benefit obligations £m	Depreciation in excess of capital allowances £m	Non-distributable reserve[1] £m	Investment properties £m	Share-based payments £m	AFS revaluation reserve £m	Total £m
At 1 January 2017	2.6	(2.1)	(1.0)	(23.4)	(8.2)	4.1	(18.0)	(46.0)
Credit to the income statement	–	–	1.5	4.8	8.2	0.2	–	14.7
(Charge) / credit to other comprehensive income	–	(0.4)	–	–	–	–	2.2	1.8
Charge direct to equity	–	–	–	–	–	(1.0)	–	(1.0)
Other movements	(0.6)	–	–	–	–	–	–	(0.6)
At 31 December 2017	2.0	(2.5)	0.5	(18.6)	–	3.3	(15.8)	(31.1)
Credit / (charge) to the income statement	0.3	(0.1)	(3.9)	4.9	–	(0.5)	–	0.7
(Charge) / credit to other comprehensive income	–	(0.4)	–	–	–	–	23.8	23.4
Charge direct to equity	–	–	–	–	–	(0.6)	–	(0.6)
At 31 December 2018	2.3	(3.0)	(3.4)	(13.7)	–	2.2	8.0	(7.6)

Note:

1. The non-distributable reserve was a statutory claims equalisation reserve calculated in accordance with the rules of the PRA. With the introduction of solvency II on 1 January 2016, the requirement to maintain the claims equalisation reserve ceased and the balance at 31 December 2015 was released to retained earnings. The taxation of this release is spread over six years from the change in regulation. It is provided for in deferred tax above as it represents the future unwind of previously claimed tax deductions for transfers into the reserve.

In addition, the Group has an unrecognised deferred tax asset at 31 December 2018 of £4.7 million (2017: £7.4 million) in relation to capital losses of which £4.7 million (2017: £4.1 million) relates to realised losses and £nil (2017: £3.3 million) relates to unrealised losses.

14. Dividends and appropriations

	2018 £m	2017 £m
Amounts recognised as distributions to equity holders in the period:		
2017 final dividend of 13.6 pence per share paid on 17 May 2018	186.1	–
2016 final dividend of 9.7 pence per share paid on 18 May 2017	–	132.4
2018 first interim dividend of 7.0 pence per share paid on 7 September 2018	95.8	–
2017 first interim dividend of 6.8 pence per share paid on 8 September 2017	–	92.9
2017 special dividend of 15.0 pence per share paid on 17 May 2018	205.3	–
	487.2	225.3
Coupon payments in respect of Tier 1 notes[1]	16.6	–
	503.8	225.3
Proposed dividends:		
2018 final dividend of 14.0 pence per share	192.5	–
2017 final dividend of 13.6 pence per share	–	187.0
2018 special dividend of 8.3 pence per share	114.1	–
2017 special dividend of 15.0 pence per share	–	206.3

Note:

1. Coupon payments on the Tier 1 notes issued in December 2017 are treated as an appropriation of retained profits and, accordingly, are accounted for when paid.

The proposed final and special dividends for 2018 have not been included as a liability in these financial statements.

The trustees of the employee share trusts waived their entitlement to dividends on shares held to meet obligations arising on the Long-Term Incentive Plan, Deferred Annual Incentive Plan and Restrictive Share Plan awards, which reduced the total dividends paid for the year ended 31 December 2018 by £2.4 million (2017: £1.6 million).

15. Earnings per share

Earnings per share is calculated by dividing earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the year.

Basic

Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period, excluding Ordinary Shares held as employee trust shares.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of earnings per share	457.1	434.0
Weighted average number of Ordinary Shares (millions)	1,366.5	1,366.1
Basic earnings per share (pence)	33.5	31.8

Diluted

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period adjusted for the dilutive potential Ordinary Shares. The Company has share options and contingently issuable shares as categories of dilutive potential Ordinary Shares.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of earnings per share	457.1	434.0
Weighted average number of Ordinary Shares (millions)	1,366.5	1,366.1
Effect of dilutive potential of share options and contingently issuable shares (millions)	15.8	12.9
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,382.3	1,379.0
Diluted earnings per share (pence)	33.1	31.5

16. Net assets per share and return on equity

Net asset value per share is calculated as total shareholders' equity (which excludes Tier1 notes) divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

Tangible net asset value per share is calculated as total shareholders' equity less goodwill and other intangible assets divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

The table below analyses net asset and tangible net asset value per share.

At 31 December	2018 £m	2017 £m
Net assets	2,573.1	2,715.1
Goodwill and other intangible assets[1]	(566.8)	(471.1)
Tangible net assets	2,006.3	2,244.0
Number of Ordinary Shares (millions)	1,375.0	1,375.0
Shares held by employee share trusts (millions)	(10.4)	(9.9)
Closing number of Ordinary Shares (millions)	1,364.6	1,365.1
Net asset value per share (pence)	188.6	198.9
Tangible net asset value per share (pence)	147.0	164.4

Note:

1. Goodwill has arisen on acquisition by the Group of subsidiary companies and on acquisition of new accident repair centres. Intangible assets are primarily comprised of software development costs.

16. Net assets per share and return on equity continued

Return on equity

The table below details the calculation of return on equity.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of return on equity	457.1	434.0
Opening shareholders' equity	2,715.1	2,521.5
Closing shareholders' equity	2,573.1	2,715.1
Average shareholders' equity	2,644.1	2,618.3
Return on equity	17.3%	16.6%

17. Goodwill and other intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2017	211.3	569.9	781.2
Acquisitions and additions	1.0	72.2	73.2
At 31 December 2017	212.3	642.1	854.4
Acquisitions and additions	0.4	142.0	142.4
Disposals and write-off[1]	–	(4.7)	(4.7)
At 31 December 2018	212.7	779.4	992.1
Accumulated amortisation and impairment			
At 1 January 2017	–	272.3	272.3
Charge for the year	–	54.1	54.1
Impairment losses[2]	–	56.9	56.9
At 31 December 2017	–	383.3	383.3
Charge for the year	–	45.2	45.2
Disposals and write-off[1]	–	(4.7)	(4.7)
Impairment losses[2]	–	1.5	1.5
At 31 December 2018	–	425.3	425.3

Carrying amount			
At 31 December 2018	212.7	354.1	566.8
At 31 December 2017	212.3	258.8	471.1

Notes:

1. Disposals and write-off include fully amortised intangible assets no longer utilised by the Group in its operating activities.
2. The impairment losses relate to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

Included within other intangible assets, are assets still in development of £269.9 million (2017: £171.4 million). These assets are reviewed for potential indicators of impairment at each reporting date.

Goodwill arose on the acquisition of U K Insurance Limited (£141.0 million), Churchill Insurance Company Limited (£70.0 million) and accident repair networks (£1.7 million) and is allocated to reportable segments. The addition to goodwill in the year ended 31 December 2018 of £0.4 million arose on acquisition of a new accident repair centre.

The Group's testing for goodwill impairment includes the comparison of the recoverable amount of each CGU to which goodwill has been allocated with its carrying value and updated at each reporting date in the event of indications of impairment.

The table below analyses the goodwill of the Group by CGU.

	2018 £m	2017 £m
Motor	128.1	127.7
Home	45.8	45.8
Rescue and other personal lines	28.7	28.7
Commercial	10.1	10.1
Total	212.7	212.3

There have been no impairments in goodwill for the year ended 31 December 2018 (2017: £nil).

The recoverable amount is the higher of the CGU fair value less the costs to sell and its value-in-use. Value-in-use is the present value of expected future cash flows from the CGU. Fair value is the estimated amount that could be obtained from the sale of the CGU in an arm's length transaction between knowledgeable and willing parties.

The recoverable amounts of all CGUs were based on the value-in-use test, using the Group's strategic plan. The long-term growth rates have been based on gross domestic product rates adjusted for inflation. The risk discount rates incorporate observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium based on independent analysis.

The table below details the recoverable amounts in excess of carrying value for the CGUs where goodwill is held.

	Assumptions			Sensitivity: Impact on recoverable amount of a:		
CGU	Terminal growth rate %	Pre-tax discount rate %	Recoverable amount in excess of carrying value £m	1% decrease in terminal growth rate £m	1% increase in pre-tax discount rate £m	1% decrease in forecast pre-tax profit[1] £m
Motor	3.0	11.5	1,112.3	(247.4)	(264.2)	(32.5)
Home	3.0	11.5	777.3	(81.8)	(112.0)	(10.6)
Rescue and other personal lines	3.0	11.5	557.7	(56.0)	(75.7)	(6.6)
Commercial	3.0	11.5	575.4	(85.0)	(114.8)	(10.0)

Note:

1. Reflects a 1% decrease in the profit for each year of the strategic plan, which is five years.

18. Property, plant and equipment

	Freehold land and buildings £m	Other equipment £m	Total £m
Cost			
At 1 January 2017	79.8	196.3	276.1
Additions	–	22.4	22.4
Disposals	–	(15.1)	(15.1)
At 31 December 2017	79.8	203.6	283.4
Additions	–	13.3	13.3
Disposals	–	(31.9)	(31.9)
At 31 December 2018	79.8	185.0	264.8
Accumulated depreciation and impairment			
At 1 January 2017	3.1	92.1	95.2
Depreciation charge for the year	1.1	26.8	27.9
Disposals	–	(14.1)	(14.1)
At 31 December 2017	4.2	104.8	109.0
Depreciation charge for the year	1.1	30.0	31.1
Disposals	–	(31.5)	(31.5)
At 31 December 2018	5.3	103.3	108.6

Carrying amount			
At 31 December 2018	74.5	81.7	156.2
At 31 December 2017	75.6	98.8	174.4

The Group is satisfied that the aggregate value of property, plant and equipment is not less than its carrying value.

19. Investment property

	2018 £m	2017 £m
At 1 January	309.3	329.0
Additions at cost	0.1	–
Increase in fair value during the year	12.7	21.6
Disposals	–	(41.3)
At 31 December	322.1	309.3

Note:

1. The cost included in the carrying value at 31 December 2018 is £252.5 million (2017: £252.4 million).

The investment properties are measured at fair value derived from valuation work carried out at the balance sheet date by independent property valuers.

The valuation conforms to international valuation standards. The fair value was determined using a methodology based on recent market transactions for similar properties, which have been adjusted for the specific characteristics of each property within the portfolio. This approach to valuation is consistent with the methodology used in the year ended 31 December 2017.

Lease agreements with tenants are drawn up in line with local practice and the Group has no exposure to leases that include contingent rents.

20. Subsidiaries

The principal subsidiary undertakings of the Group, over which it exercises 100% voting power, are shown below. Their capital consists of Ordinary Shares which are unlisted. All subsidiaries (a full list of which is included in note 2 of the Parent Company's financial statements) are included in the Group's consolidated financial statements.

Name of subsidiary	Place of incorporation and operation	Principal activity
DL Insurance Services Limited	United Kingdom	Management services
U K Insurance Limited	United Kingdom	General insurance

The Group did not dispose of any subsidiaries in the years ended 31 December 2018 and 31 December 2017.

21. Reinsurance assets

	Notes	2018 £m	2017 £m
Reinsurers' share of general insurance liabilities		1,159.9	1,141.1
Impairment provision[1]		(54.7)	(59.9)
Total excluding reinsurers' unearned premium reserves	33	1,105.2	1,081.2
Reinsurers' unearned premium reserve	34	103.5	97.3
Total		1,208.7	1,178.5

Note:

1. Impairment provision relates to reinsurance debtors, allowing for the risk that reinsurance assets may not be collected, or where the reinsurer's credit rating has been significantly downgraded and may have difficulty in meeting its obligations.

Movements in reinsurance asset impairment provision

	2018 £m	2017 £m
At 1 January	(59.9)	(50.7)
Additional provision	(7.5)	(9.6)
Release to income statement	12.7	0.4
At 31 December	(54.7)	(59.9)

22. Deferred acquisition costs

	2018 £m	2017 £m
At 1 January	185.4	203.1
Net decrease in the year	(14.4)	(17.7)
At 31 December	171.0	185.4

23. Insurance and other receivables

	2018 £m	2017 £m
Receivables arising from insurance contracts:		
Due from policyholders	740.4	840.4
Due from agents, brokers and intermediaries	82.9	71.3
Impairment provision of policyholder receivables	(0.9)	(1.2)
Impairment provision of agent, broker and intermediary receivables	(0.5)	(0.9)
Other debtors	54.0	71.6
Total	875.9	981.2

Movement in impairment provisions during the year

	Policyholders £m	Agents, brokers and intermediaries £m	Total £m
At 1 January 2018	1.2	0.9	2.1
Additional provision	24.7	0.2	24.9
Released to income statement	(25.0)	(0.6)	(25.6)
At 31 December 2018	0.9	0.5	1.4

24. Derivative financial instruments

	2018 £m	2017 £m
Derivative assets		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	19.2	51.1
Designated as hedging instruments:		
Foreign exchange contracts (forwards)[1]	1.4	1.0
Interest rate swaps	27.6	32.3
Total	48.2	84.4
Derivative liabilities		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	20.6	11.3
Designated as hedging instruments:		
Interest rate swaps	5.3	0.7
Total	25.9	12.0

Note:
1. Cash flow hedges in relation to supplier payments.

25. Retirement benefit obligations

Defined contribution scheme

The pension charge in respect of the defined contribution scheme for the year ended 31 December 2018 was £28.7 million (2017: £25.5 million).

Defined benefit scheme

The Group's defined benefit pension scheme was closed in 2003 although the Group remains the sponsoring employer for obligations to current and deferred pensioners based on qualifying years' service and final salaries. The defined benefit scheme is legally separated from the Group with trustees who are required by law to act in the interests of the scheme and of all the relevant stakeholders. The trustees of the pension scheme are responsible for the investment policy with regard to the assets of the scheme.

The weighted average duration of the defined benefit obligations at 31 December 2018 is 20 years (2017: 20 years) using accounting assumptions.

The table below sets out the principal assumptions used in determining the defined benefit scheme obligations.

	2018 %	2017 %
Rate of increase in pension payment	2.2	2.2
Rate of increase of deferred pensions	2.2	2.2
Discount rate	2.9	2.5
Inflation rate	3.3	3.3

25. Retirement benefit obligations continued

No assumption has been made for salary growth as there are no obligations in the scheme that are linked to future increases in salaries.

Post-retirement mortality assumptions

	2018	2017
Life expectancy at age 60 now:		
Males	87.3	87.5
Females	89.0	89.2
Life expectancy at age 60 in 20 years' time:		
Males	89.1	89.3
Females	90.9	91.1

The table below analyses the fair value of the scheme assets by type of asset.

	2018 £m	2017 £m
Index-linked bonds	30.4	28.7
Government bonds	24.9	17.7
Liquidity fund[1]	0.8	52.7
Absolute return bond fund[2]	39.4	–
Other	0.1	2.6
Total	95.6	101.7

Notes:

1. The liquidity fund is an investment in an open-ended fund incorporated in the Republic of Ireland which targets capital stability and income in the UK. It is invested in short-term fixed income and variable rate securities (such as Treasury Bills) listed or traded on one or more recognised exchange.
2. The absolute return bond fund is an investment in an open-ended fund incorporated in Luxembourg which targets positive returns in all market conditions. It is invested in short-term fixed income asset classes and seeks additional returns via a range of additional investments including certificate of deposits, rates and global currencies.

The majority of debt instruments have quoted prices in active markets. The absolute return bond fund holds bonds that, rather than being traded on exchange, are traded through agents, brokers or investment banks matching buyers and sellers.

Movement in net pension surplus

	Fair value of defined benefit scheme assets £m	Present value of defined benefit scheme obligations £m	Net pension surplus £m
At 1 January 2017	102.5	(90.5)	12.0
Income statement:			
Net interest income / (cost)[1]	2.7	(2.4)	0.3
Statement of comprehensive income:			
Actuarial gains arising from experience adjustments	1.0	1.5	2.5
Actuarial gains arising from changes in demographic assumptions	–	3.1	3.1
Actuarial losses arising from changes in financial assumptions	–	(3.5)	(3.5)
Benefits paid	(4.5)	4.5	–
At 31 December 2017	101.7	(87.3)	14.4
Income statement:			
Net interest income / (cost)[1]	2.4	(2.1)	0.3
Administration costs	(0.2)	–	(0.2)
Prior service costs[2]	–	(0.2)	(0.2)
Settlement[3]	(2.4)	2.4	–
Statement of comprehensive income:			
Actuarial losses arising from experience adjustments	(3.5)	–	(3.5)
Actuarial gains arising from changes in demographic assumptions	–	0.4	0.4
Actuarial gains arising from changes in financial assumptions	–	5.8	5.8
Benefits paid	(2.4)	2.4	–
At 31 December 2018	95.6	(78.6)	17.0

Notes:

1. The net interest income / (cost) in the income statement has been included under other operating expenses.
2. This results from the outcome of a court case ruling in October 2018 involving the Lloyds Bank pension schemes but leading to a one-off increase in liabilities for UK pension schemes more widely.
3. A number of historical annuity policies held by the scheme were transferred to individual members during the year.

The table below details the history of the scheme for the current and prior years.

	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Present value of defined benefit scheme obligations	(78.6)	(87.3)	(90.5)	(72.0)	(79.6)
Fair value of defined benefit scheme assets	95.6	101.7	102.5	85.1	83.1
Net surplus	**17.0**	14.4	12.0	13.1	3.5
Experience adjustment gains on scheme liabilities	–	1.5	1.2	1.2	1.0
Experience adjustment (losses) / gains on scheme assets	(3.5)	1.0	13.7	(1.9)	12.9

Sensitivity analysis
The table below provides a sensitivity analysis of the potential impact of a change in a single factor with all other assumptions left unchanged. Other potential risks beyond the ones described in the table could have an additional financial impact on the Group. This sensitivity analysis has been selected to reflect the changes to discounted cash flows as a result of changes to the discount rate, inflation rate and mortality assumptions. The methodology adopted involves actuarial techniques.

	Impact on pension cost		Impact on present value of defined benefit scheme obligations	
	2018 £m	2017 £m	2018 £m	2017 £m
Discount rate				
0.25% increase in discount rate	(0.2)	(0.2)	(3.9)	(4.4)
0.25% decrease in discount rate	0.1	0.1	3.9	4.4
Inflation rate				
0.25% increase in inflation rate	–	–	2.0	2.2
0.25% decrease in inflation rate	–	–	(2.0)	(2.2)
Life expectancy				
1 year increase in life expectancy	0.1	0.1	2.7	3.1
1 year decrease in life expectancy	(0.1)	(0.1)	(2.7)	(3.1)

The most recent funding valuation of the Group's defined benefit scheme was carried out as at 1 October 2017. This showed an excess of assets over liabilities. The Group agreed with the trustees to make contributions of up to £1.5 million per annum in 2019, 2020 and 2021 in the event that a deficit subsequently emerges on the anniversary of the funding valuation date. As a result of the most recent funding update, no contributions are expected to be payable in 2019 (2018: £nil).

26. Financial investments

	2018 £m	2017 £m
AFS debt securities		
Corporate	3,916.0	4,170.5
Supranational	43.2	43.9
Local government	29.5	12.2
Sovereign	156.9	224.8
Total	4,145.6	4,451.4
HTM debt securities		
Corporate	101.0	103.6
Total debt securities	4,246.6	4,555.0
Total debt securities		
Fixed interest rate[1]	4,211.1	4,540.1
Floating interest rate	35.5	14.9
Total	4,246.6	4,555.0
Loans and receivables		
Infrastructure debt	289.6	316.4
Commercial real estate loans	201.6	169.0
Total	4,737.8	5,040.4

Note:
1. The Group swaps a fixed interest rate for a floating rate of interest on its US Dollar, Euro and a small amount of its sterling corporate debt securities by entering into interest rate derivatives. The hedged amount at 31 December 2018 was £1,206.1 million (2017: £1,591.5 million).

27. Cash and cash equivalents and borrowings

	2018 £m	2017 £m
Cash at bank and in hand	157.4	258.0
Short-term deposits with credit institutions[1]	997.0	1,100.6
Cash and cash equivalents	1,154.4	1,358.6
Bank overdrafts[2]	(62.0)	(54.1)
Cash and bank overdrafts[3]	1,092.4	1,304.5

Notes:

1. This represents money market funds with no notice period for withdrawal.
2. Bank overdrafts represent short-term timing differences between transactions posted in the records of the Group and transactions flowing through the accounts at the bank.
3. Cash and bank overdrafts disclosure note is included for the purposes of the consolidated cash flow statement.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2018 was 0.58% (2017: 0.29%) and average maturity was 10 days (2017: 10 days).

28. Assets held for sale

	2018 £m	2017[1] £m
Freehold property held for sale	–	4.2

Note:

1. The freehold property held for sale at 31 December 2017 related to a property in Bristol which was sold in January 2018.

29. Share capital

	2018 Number millions	2017 Number millions	2018 £m	2017 £m
Issued and fully paid: equity shares				
Ordinary Shares of $10^{10}/_{11}$ pence each[1]	1,375	1,375	150.0	150.0

Note:

1. The shares have full voting dividend and capital distribution rights (including wind up) attached to them; these do not confer any rights of redemption.

Employee trust shares

The Group satisfies share-based payments under the Group's share plans primarily through shares purchased in the market and held by employee share trusts.

At 31 December 2018, 10,432,376 Ordinary Shares (2017: 9,945,473 Ordinary Shares) were owned by the employee share trusts with a cost of £35.2 million (2017: £34.1 million). These Ordinary Shares are carried at cost and at 31 December 2018 had a market value of £33.2 million (2017: £38.0 million).

30. Other reserves

Movements in the AFS investments revaluation reserve

	2018 £m	2017 £m
At 1 January	80.2	92.1
Revaluation during the year – gross	(121.4)	8.8
Revaluation during the year – tax	20.6	(1.5)
Realised gains – gross	(19.5)	(23.2)
Realised gains – tax	3.3	4.0
At 31 December	(36.8)	80.2

Capital reserves

	2018 £m	2017 £m
Capital contribution reserve[1]	100.0	100.0
Capital redemption reserve[2]	1,350.0	1,350.0
Total	1,450.0	1,450.0

Notes:

1. Arose on the cancellation of a debt payable to a shareholder.
2. Arose on the reduction of nominal value of each share in issue with a corresponding transfer to capital redemption reserve.

31. Tier 1 notes

	2018 £m	2017 £m
Tier 1 notes	346.5	346.5

On 7 December 2017, the Group issued £350 million of fixed rate perpetual Tier 1 notes with a coupon rate of 4.75% per annum.

The Group has an optional redemption date of 7 December 2027. If the notes are not repaid on that date, a fixed rate of interest per annum will be reset. The notes are direct, unsecured and subordinated obligations of the issuer ranking pari passu and without any preference amongst themselves.

The Tier 1 notes are treated as a separate category within equity and the coupon payments are recognised outside of the profit after tax result and directly in shareholders' equity.

The Group has the option to cancel the coupon payment which becomes mandatory upon breach of non-compliance with the Group SCR, a breach of the minimum capital requirement or where the Group has insufficient distributable reserves.

32. Subordinated liabilities

	2018 £m	2017 £m
Subordinated guaranteed dated notes	259.5	264.7

The subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year designated hedging instrument to exchange the fixed rate of interest for a floating rate of 3-month LIBOR plus a spread of 706 basis points which was credit value adjusted to 707 basis points with effect from 29 July 2013.

On 8 December 2017, the Group repurchased £250 million nominal value of the subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million.

The remaining notes, with a nominal value of £250 million, have a redemption date of 27 April 2042 with the option to repay the notes on 27 April 2022. If the notes are not repaid on that date, the rate of interest will be reset at a rate of the 6-month LIBOR plus 7.91%.

The Group has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The notes are unsecured, subordinated obligations of the Group, and rank pari passu without any preference among themselves. In the event of a winding-up or of bankruptcy, they are to be repaid only after the claims of all other senior creditors have been met.

33. Insurance liabilities

	2018 £m	2017 £m
Insurance liabilities	4,005.9	4,225.7

Gross insurance liabilities

Accident year	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	Total £m
Estimate of ultimate gross claims costs:											
At end of accident year	3,823.3	3,941.7	2,698.1	2,372.7	2,184.0	2,094.5	2,118.1	2,157.7	2,217.3	2,300.1	
One year later	121.6	(117.1)	(99.3)	(163.3)	(117.6)	20.7	(30.0)	(86.7)	(116.2)		
Two years later	(37.0)	(99.1)	(94.6)	(118.9)	(153.0)	(38.4)	(143.5)	(53.3)			
Three years later	(14.0)	(50.3)	(89.3)	(49.3)	(21.0)	(144.9)	(62.4)				
Four years later	(101.5)	(105.5)	(60.9)	(9.9)	(102.1)	(50.2)					
Five years later	(38.8)	(57.7)	(21.2)	(79.2)	(50.8)						
Six years later	(80.8)	(25.9)	(60.3)	(36.2)							
Seven years later	(27.3)	(50.0)	(25.1)								
Eight years later	(14.0)	(17.6)									
Nine years later	(36.4)										
Current estimate of cumulative claims	3,595.1	3,418.5	2,247.4	1,915.9	1,739.5	1,881.7	1,882.2	2,017.7	2,101.1	2,300.1	
Cumulative payments to date	(3,474.6)	(3,323.4)	(2,172.8)	(1,862.3)	(1,655.4)	(1,592.6)	(1,547.7)	(1,554.6)	(1,471.4)	(1,174.0)	
Gross liability recognised in balance sheet	120.5	95.1	74.6	53.6	84.1	289.1	334.5	463.1	629.7	1,126.1	3,270.4
2008 and prior											655.5
Claims handling provision											80.0
Total											4,005.9

Net insurance liabilities

Accident year	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	Total £m
Estimate of ultimate net claims costs:											
At end of accident year	3,790.6	3,902.0	2,644.4	2,271.8	2,093.9	1,971.0	1,926.7	1,922.2	2,016.9	2,125.9	
One year later	70.0	(125.2)	(131.5)	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)	(79.7)		
Two years later	(17.4)	(120.4)	(82.1)	(107.8)	(134.4)	(42.0)	(77.8)	(38.2)			
Three years later	(54.1)	(44.0)	(76.5)	(35.6)	(27.8)	(100.7)	(30.4)				
Four years later	(67.0)	(93.6)	(48.7)	(11.6)	(64.3)	(41.3)					
Five years later	(29.6)	(52.3)	(37.3)	(54.2)	(38.9)						
Six years later	(74.6)	(43.9)	(37.0)	(30.4)							
Seven years later	(38.2)	(24.8)	(20.4)								
Eight years later	(0.4)	(17.4)									
Nine years later	(35.1)										
Current estimate of cumulative claims	3,544.2	3,380.4	2,210.9	1,885.5	1,704.9	1,757.3	1,751.5	1,865.1	1,937.2	2,125.9	
Cumulative payments to date	(3,441.4)	(3,308.2)	(2,149.3)	(1,845.4)	(1,637.1)	(1,585.0)	(1,544.1)	(1,548.8)	(1,470.3)	(1,173.7)	
Net liability recognised in balance sheet	102.8	72.2	61.6	40.1	67.8	172.3	207.4	316.3	466.9	952.2	2,459.6
2008 and prior											361.1
Claims handling provision											80.0
Total											2,900.7

Movements in gross and net insurance liabilities

	Gross[1] £m	Reinsurance £m	Net[1] £m
Claims reported	2,584.5	(388.3)	2,196.2
Incurred but not reported	2,002.8	(890.0)	1,112.8
Claims handling provision	79.3	–	79.3
At 1 January 2017	4,666.6	(1,278.3)	3,388.3
Cash paid for claims settled in the year	(2,012.0)	14.0	(1,998.0)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,389.9	(200.3)	2,189.6
Arising from prior-year claims	(818.8)	383.4	(435.4)
At 31 December 2017	4,225.7	(1,081.2)	3,144.5
Claims reported	3,003.7	(742.5)	2,261.2
Incurred but not reported	1,142.7	(338.7)	804.0
Claims handling provision	79.3	–	79.3
At 31 December 2017	4,225.7	(1,081.2)	3,144.5
Cash paid for claims settled in the year	**(2,186.7)**	**31.1**	**(2,155.6)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,490.4**	**(174.2)**	**2,316.2**
Arising from prior-year claims	**(523.5)**	**119.1**	**(404.4)**
At 31 December 2018	**4,005.9**	**(1,105.2)**	**2,900.7**
Claims reported	**3,001.0**	**(809.8)**	**2,191.2**
Incurred but not reported	**924.9**	**(295.4)**	**629.5**
Claims handling provision	**80.0**	**–**	**80.0**
At 31 December 2018	**4,005.9**	**(1,105.2)**	**2,900.7**

Note:

1. Included within the incurred but not reported claims provision is a £55 million net release (gross: £175 million release) relating to assumed changes to the Ogden discount rate which have not yet been reflected in claims reported (31 December 2017: gross and net £nil; 1 January 2017: £217 million net provision increase; £542 million gross provision increase).

Movement in prior-year net claims liabilities by operating segment

	2018 £m	2017 £m
Motor[1]	**(276.3)**	(318.6)
Home	**(32.6)**	(23.7)
Rescue and other personal lines	**(16.1)**	(6.8)
Commercial	**(79.4)**	(86.3)
Total	**(404.4)**	(435.4)

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including the Run-off segment. Comparative data has been re-presented accordingly to include Run-off segment prior-year claims movements within the Motor segment (2017: £43.1 million).

34. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2017	1,547.9	(93.5)	1,454.4
Net movement in the year	52.4	(3.8)	48.6
At 31 December 2017	1,600.3	(97.3)	1,503.0
Net movement in the year	**(94.8)**	**(6.2)**	**(101.0)**
At 31 December 2018	**1,505.5**	**(103.5)**	**1,402.0**

35. Share-based payments

The Group operates equity-settled, share-based compensation plans in the form of an LTIP, a Restricted Shares Plan, a DAIP and Direct Line Group Share Incentive Plans, including both the Free Share awards and a Buy-As-You-Earn Plan, details of which are set out below. All awards are to be satisfied using market purchased shares.

Long-Term Incentive Plan

Executive Directors and certain members of senior management are eligible to participate in the LTIP with awards granted in the form of nil-cost options. Under the plan, the shares vest at the end of a three-year period dependent upon the continued employment by the Group and also the Group achieving predefined performance conditions associated with TSR and RoTE. For awards since August 2017, the Directors are subject to an additional two-year holding period following the three-year vesting period.

Awards were made in the year ended 31 December 2018 over 3.9 million Ordinary Shares with an estimated fair value of £10.5 million at the 2018 grant dates (2017: 4.2 million Ordinary Shares with an estimated fair value of £15.2 million).

The estimated fair value of the LTIP share awards with market-based performance conditions was calculated using a Monte-Carlo simulation model.

The table below details the inputs into the model.

	2018	2017
Weighted average assumptions during the year:		
Share price (pence)	355	359
Exercise price (pence)	0	0
Volatility of share price	21%	20%
Average comparator volatility	30%	30%
Expected life	3 years	3 years
Risk-free rate	0.9%	0.2%

Expected volatility was determined by considering the actual volatility of the Group's share price since its initial public offering and that of a group of listed UK insurance companies.

Plan participants are entitled to receive additional shares in respect of dividends paid to shareholders over the vesting period. Therefore, no deduction has been made from the fair value of awards in respect of dividends.

Expected life was based on the contractual life of the awards and adjusted based on management's best estimate, for the effects of exercise restrictions and behavioural considerations.

Restricted Shares Plan

The purpose of the Restricted Shares Plan is to facilitate the wider participation in Group share-based awards to eligible employees. These awards can be granted at any time during the year, generally have no performance criteria, and vest over periods ranging between one and three years from the date of the grant, subject to continued employment. During the year awards were made over 0.5 million Ordinary Shares (2017: 1.1 million Ordinary Shares) with an estimated fair value of £1.6 million (2017: £3.9 million) using the market value at the date of grant.

Deferred Annual Incentive Plan

To incentivise delivery of performance over a one-year operating cycle, Executive Directors and certain members of senior management are eligible for awards under the AIP, of which at least 40% is granted in the form of a nil-cost option under the DAIP with the remainder being settled in cash following year end. During the year awards were made over 1.3 million Ordinary Shares (2017: 0.9 million Ordinary Shares) under this plan with an estimated fair value of £4.9 million (2017: £2.9 million) using the market value at the date of grant.

The awards outstanding at 31 December 2018 have no performance criteria attached; there is a requirement that the employee remains in employment with the Group for three years from the date of grant.

Direct Line Group Share Incentive Plans: Free Share awards

In early 2018, the Group offered all eligible employees a Free Share award granting 133 Ordinary Shares free of charge to celebrate the Group's fifth anniversary in October 2017 of its launch on the London Stock Exchange. These awards have no performance criteria attached and vest on the third anniversary of the award grant date, subject to completion of three years, continuing employment. The Group initially granted 1.4 million Ordinary Shares with an estimated fair value of £5.4 million using the market value at the date of grant.

Direct Line Group Share Incentive Plans: Buy-As-You-Earn Plan

The Buy-As-You-Earn Plan entitles employees to purchase shares from pre-tax pay for between £10 and £150 per month and receive one matching share for every two shares purchased.

In the year ended 31 December 2018, matching share awards were granted over 0.4 million Ordinary Shares (2017: 0.4 million Ordinary Shares) with an estimated fair value of £1.5 million (2017: £1.3 million). The fair value of each matching share award is estimated using the market value at the date of grant.

Under the plan, the shares vest at the end of a three-year period dependent upon the continued employment with the Group together with continued ownership of the associated purchased shares up to the point of vesting.

Movement in total share awards

	Number of share awards	
	2018 millions	2017 millions
At 1 January	**20.2**	18.1
Granted during the year[1]	**9.2**	9.6
Forfeited during the year	**(2.7)**	(1.3)
Exercised during the year	**(5.4)**	(6.2)
At 31 December	**21.3**	20.2
Exercisable at 31 December	**1.5**	1.9

Note:

1. In accordance with the rules of the LTIP and DAIP award plans, additional awards of 1.7 million shares were granted during the year ended 31 December 2018 (2017: 3.0 million) in respect of the equivalent dividend.

In respect of the outstanding options at 31 December 2018, the weighted average remaining contractual life is 1.58 years (2017: 1.39 years). No share awards expired during the year (2017: nil).

The weighted average share price for awards exercised during the year ended 31 December 2018 was £3.58 (2017: £3.61).

The Group recognised total expenses in the year ended 31 December 2018 of £21.0 million (2017: £14.8 million) relating to equity-settled share-based compensation plans.

Further information on share-based payments, in respect of Executive Directors, is provided in the Directors' remuneration report.

36. Trade and other payables, including insurance payables

	2018 £m	2017 £m
Trade creditors and accruals	**227.7**	282.8
Other taxes	**100.0**	103.9
Other creditors	**89.1**	95.9
Provisions	**72.8**	74.2
Due to reinsurers	**47.4**	74.2
Due to agents, brokers and intermediaries	**11.9**	18.2
Deferred income	**4.7**	4.8
Due to insurance companies	**0.5**	4.0
Total	**554.1**	658.0

Movement in provisions during the year

	Regulatory levies £m	Restructuring £m	Other £m	Total £m
At 1 January 2018	**31.7**	**6.4**	**36.1**	**74.2**
Additional provision	**47.5**	**2.8**	**32.5**	**82.8**
Utilisation of provision	**(43.6)**	**(1.9)**	**(26.0)**	**(71.5)**
Released to income statement	**–**	**(3.9)**	**(8.8)**	**(12.7)**
At 31 December 2018	**35.6**	**3.4**	**33.8**	**72.8**

37. Notes to the consolidated cash flow statement

	2018 £m	2017 £m
Profit for the year	473.7	434.0
Adjustments for:		
Investment return	(154.6)	(175.4)
Instalment income	(119.9)	(116.4)
Finance costs	19.1	103.8
Defined benefit pension scheme – net interest charge / (income)	0.1	(0.3)
Equity-settled share-based payment charge	21.0	14.8
Tax charge	108.9	105.0
Depreciation and amortisation charge	76.3	82.0
Impairment of property, plant and equipment, goodwill and intangible assets	1.5	56.9
Impairment provision movements on reinsurance contracts	(5.2)	9.2
Gain on sale / fair value adjustment on assets held for sale	(9.6)	(0.4)
Loss on sale of property, plant and equipment	0.3	0.7
Operating cash flows before movements in working capital	411.6	513.9
Movements in working capital:		
Net decrease in net insurance liabilities including reinsurance assets, unearned premium reserves and deferred acquisition costs	(325.2)	(186.7)
Net decrease / (increase) in prepayments and accrued income and other assets	18.2	(15.2)
Net decrease in insurance and other receivables	105.3	7.1
Net decrease in trade and other payables, including insurance payables	(103.9)	(41.2)
Cash generated from operations	106.0	277.9
Taxes paid	(102.6)	(76.5)
Cash flow hedges	0.8	2.6
Net cash generated from operating activities before investment of insurance assets	4.2	204.0
Interest received	303.6	316.6
Rental income received from investment property	15.9	16.2
Purchase of investment property	(0.1)	–
Proceeds on disposal of investment property	–	41.3
Proceeds on disposal / maturity of AFS debt securities	2,159.2	1,948.4
Proceeds from maturity of HTM debt securities	2.5	–
Advances made for infrastructure debt and commercial real estate loans	(59.3)	(108.5)
Repayments of infrastructure debt	49.2	31.8
Purchase of AFS debt securities	(2,002.9)	(1,885.4)
Purchase of HTM debt securities	–	(18.5)
Cash generated from investment of insurance assets	468.1	341.9

The table below details changes in liabilities arising from the Group's financing activities.

	Subordinated liabilities		Interest rate swaps[1]	
	2018 £m	2017 £m	2018 £m	2017 £m
At 1 January	(264.7)	(539.6)	16.3	38.4
Repayment of subordinated liabilities	–	326.8	–	–
Interest paid on subordinated liabilities[2]	23.1	51.6	–	–
Interest rate swap cash settlement	–	–	(5.8)	(19.9)
Financing cash flows	23.1	378.4	(5.8)	(19.9)
Premium paid to buy back of debt issued	–	(76.8)	–	–
Amortisation of arrangement costs and discount on issue of subordinated liabilities	(0.4)	(2.2)	–	–
Accrued interest expense on subordinated liabilities	(23.1)	(47.5)	–	–
Unrealised gain on associated interest rate risk on hedged item	5.6	11.7	–	–
Realised gain on associated interest rate risk on hedged item	–	11.3	–	10.7
Net accrued interest on interest rate swap	–	–	(0.2)	(1.2)
Fair value movement in interest rate swap	–	–	(1.3)	(11.7)
Non-cash changes	(17.9)	(103.5)	(1.5)	(2.2)
At 31 December	(259.5)	(264.7)	9.0	16.3

Notes:

1. The interest rate swaps relate to the Group's 10-year designated hedging instrument which exchanges the fixed rate of interest for a floating rate of 3-month LIBOR plus a spread of 706 basis points which was credit value adjusted to 707 basis points with effect from 29 July 2013.
2. This includes £2.7 million of accrued interest settled in relation to the £250 million of repayment of subordinated guaranteed notes in 2017.

38. Contingent liabilities

The Group did not have any material contingent liabilities at 31 December 2018 (2017: none).

39. Commitments

Operating lease commitments where the Group is the lessee

The Group has entered into non-cancellable operating lease agreements for properties, vehicles and other assets.

	2018 £m	2017 £m
Lease payments under operating leases recognised as an expense in the year	21.3	18.8

The following table analyses the outstanding commitments for future minimum lease payments under non-cancellable operating leases by the period in which they fall due.

	2018 £m	2017 £m
Within one year	19.2	19.2
In the second to fifth years inclusive	56.4	58.1
After five years	148.7	154.8
Total	224.3	232.1

Operating lease commitments where the Group is the lessor

The following table analyses future aggregate minimum lease payments receivable under non-cancellable operating leases in respect of property leased to third-party tenants.

	2018 £m	2017 £m
Within one year	14.5	15.3
In the second to fifth years inclusive	42.9	46.1
After five years	70.4	73.1
Total	127.8	134.5

40. Fair value

Fair value hierarchy

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique.

For disclosure purposes, fair value measurements are classified as level 1, 2 or 3 based on the degree to which fair value is observable:

- level 1 financial assets are measured in whole or in part by reference to published quotes in an active market. In an active market quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.
- level 2 financial assets and liabilities are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These are assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, or financial assets with fair values based on broker quotes or assets that are valued using the Group's own models whereby the majority of assumptions are market-observable.
- level 3 fair value measurements used for investment properties, HTM debt securities, infrastructure debt and commercial real estate loans are those derived from a valuation technique that includes inputs for the asset that are unobservable.

Comparison of carrying value to fair value of financial instruments and assets carried at fair value

The following table compares the carrying value and the fair value of financial instruments and other assets where the Group discloses a fair value.

At 31 December 2018	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Investment property (note 19)	322.1	–	–	322.1	322.1
Derivative assets (note 24)	48.2	–	48.2	–	48.2
AFS debt securities (note 26)	4,145.6	156.9	3,988.7	–	4,145.6
Other financial assets:					
HTM debt securities (note 26)	101.0	–	13.9	87.4	101.3
Infrastructure debt (note 26)	289.6	–	–	286.3	286.3
Commercial real estate loans (note 26)	201.6	–	–	201.6	201.6
Total	5,108.1	156.9	4,050.8	897.4	5,105.1
Liabilities held at fair value:					
Derivative liabilities (note 24)	25.9	–	25.9	–	25.9
Other financial liabilities:					
Subordinated liabilities (note 32)	259.5	–	297.8	–	297.8
Total	285.4	–	323.7	–	323.7

At 31 December 2017	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Investment property (note 19)	309.3	–	–	309.3	309.3
Derivative assets (note 24)	84.4	–	84.4	–	84.4
AFS debt securities (note 26)	4,451.4	224.8	4,226.6	–	4,451.4
Other financial assets:					
HTM debt securities (note 26)	103.6	–	14.4	92.8	107.2
Infrastructure debt (note 26)	316.4	–	–	326.0	326.0
Commercial real estate loans (note 26)	169.0	–	–	169.0	169.0
Total	5,434.1	224.8	4,325.4	897.1	5,447.3
Liabilities held at fair value:					
Derivative liabilities (note 24)	12.0	–	12.0	–	12.0
Other financial liabilities:					
Subordinated liabilities (note 32)	264.7	–	328.7	–	328.7
Total	276.7	–	340.7	–	340.7

Differences arise between carrying value and fair value where the measurement basis of the asset or liability is not fair value (e.g. assets and liabilities carried at amortised cost). Fair values of the following assets and liabilities approximate their carrying values:

– insurance and other receivables;
– cash and cash equivalents;
– borrowings; and
– trade and other payables, including insurance payables (excluding provisions).

The movements in assets held at fair value and classified as level 3 in the fair value hierarchy are within investment property and are analysed in note 19. There were no changes in the categorisation of assets between levels 1, 2 and 3 for assets and liabilities held by the Group since 31 December 2017.

41. Related parties

Transactions between the Group's subsidiary undertakings, which are related parties, have been eliminated on consolidation and accordingly are not disclosed.

There were no sales and purchases of products and services to or from related parties in the year ended 31 December 2018 (2017: £nil).

Compensation of key management

	2018 £m	2017 £m
Short-term employee benefits	11.2	10.6
Share-based payments	8.9	5.5
Total	20.1	16.1

PARENT COMPANY BALANCE SHEET
As at 31 December 2018

	Notes	2018 £m	2017 £m
Assets			
Investment in subsidiary undertakings	2	3,119.0	3,099.1
Other receivables	3	548.3	613.5
Current tax assets	4	–	16.1
Derivative financial instruments	5	1.4	1.0
Financial investments	6	5.1	5.2
Cash and cash equivalents	7	236.1	209.3
Total assets		3,909.9	3,944.2
Equity			
Shareholders' equity		3,205.8	3,257.5
Tier 1 notes	9	346.5	346.5
Total equity		3,552.3	3,604.0
Liabilities			
Subordinated liabilities	10	253.0	252.7
Borrowings	11	100.7	84.5
Derivative financial instruments	5	1.4	1.0
Trade and other payables	12	1.7	1.4
Deferred tax liabilities	4	0.6	0.6
Current tax liabilities	4	0.2	–
Total liabilities		357.6	340.2
Total equity and liabilities		3,909.9	3,944.2

The attached notes on pages 184 to 188 form an integral part of these separate financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 4 March 2019. They were signed on its behalf by:

PENNY JAMES
CHIEF FINANCIAL OFFICER

Direct Line Insurance Group plc

Registration No. 02280426

PARENT COMPANY STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2018

	2018 £m	2017 £m
Profit for the year	449.6	50.6
Other comprehensive loss		
Items that may be reclassified subsequently to income statement:		
Fair value loss on fair value through other comprehensive income investments	(0.1)	(0.4)
Tax relating to items that may be reclassified	–	0.1
Other comprehensive loss for the year net of tax	(0.1)	(0.3)
Total comprehensive income for the year attributable to owners of the Company	449.5	50.3

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2018

	Share capital £m	Capital reserves £m	Share-based payment reserve £m	Fair value through other comprehensive income revaluation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes £m	Total equity £m
Balance at 1 January 2017	150.0	1,450.0	1.8	0.4	1,835.3	3,437.5	–	3,437.5
Total comprehensive income for the year	–	–	–	(0.3)	50.6	50.3	–	50.3
Dividends paid	–	–	–	–	(225.3)	(225.3)	–	(225.3)
Credit to equity for equity-settled share-based payments	–	–	14.8	–	–	14.8	–	14.8
Shares distributed by employee trusts	–	–	(19.8)	–	–	(19.8)	–	(19.8)
Issue of Tier 1 notes (note 9)	–	–	–	–	–	–	346.5	346.5
Balance at 31 December 2017	150.0	1,450.0	(3.2)	0.1	1,660.6	3,257.5	346.5	3,604.0
Total comprehensive income for the year	–	–	–	(0.1)	449.6	449.5	–	449.5
Dividends and appropriations paid (note 13)	–	–	–	–	(503.8)	(503.8)	–	(503.8)
Credit to equity for equity-settled share-based payments	–	–	21.0	–	–	21.0	–	21.0
Shares distributed by employee trusts	–	–	(18.4)	–	–	(18.4)	–	(18.4)
Balance at 31 December 2018	150.0	1,450.0	(0.6)	–	1,606.4	3,205.8	346.5	3,552.3

The attached notes on pages 184 to 188 form an integral part of these separate financial statements.

1. Accounting policies

1.1 Basis of preparation

Direct Line Insurance Group plc, registered in England and Wales (company number 02280426), is the ultimate parent company of the Group. The principal activity of the Company is managing its investments in subsidiaries, providing loans to those subsidiaries, raising funds for the Group and the receipt and payment of dividends.

In accordance with the exemption permitted under section 408 of the Companies Act 2006, the Company's income statement and related notes have not been presented in these separate financial statements.

The Company's financial statements are prepared in accordance with Financial Reporting Standard FRS 101 'Reduced Disclosure Framework'. In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of IFRSs issued by the IASB as adopted by the EU but makes amendments where necessary to comply with the Companies Act 2006.

The Company has taken advantage of the following FRS 101 disclosure exemptions:

- FRS 101.8 (d): the requirements of IFRS 7 'Financial Instruments: Disclosures' to make disclosures about financial instruments;
- FRS 101.8 (e): the disclosure requirements of IFRS13 'Fair Value Measurement';
- FRS 101.8 (g): the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 – 136 of IAS 1 'Presentation of Financial Statements' to produce a cash flow statement, a third balance sheet and to make an explicit and unreserved statement of compliance with IFRSs;
- FRS 101.8 (h): the requirements of IAS 7 'Statements of Cash Flows' to produce a cash flow statement and related notes;
- FRS 101.8 (i): the requirements of paragraphs 30 and 31 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' to include a list of new IFRSs that have been issued but that have yet to be applied; and
- FRS 101.8 (k): the requirements of IAS 24 'Related Party Disclosures' to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is party to a transaction is wholly owned by such a member.

1.2 Adoption of new and revised standards

The accounting policies used in the preparation of these separate financial statements are consistent with previous years, and the accounting policies applied in the consolidated financial statements of Direct Line Insurance Group plc, except for the adoption of IFRS 9 'Financial Instruments' and the additional accounting policies specific to the separate financial statements of the Company as set out below.

The Company has adopted IFRS 9 which became mandatory for the first time in 2018. IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement', introducing new guidance on the classification and measurement of financial assets, an expected credit loss impairment model, and new hedge accounting requirements.

The Company completed an impact assessment on transition to IFRS 9, including an assessment of its financial assets under the new impairment model, and concluded there was no impact on the Company's equity at 1 January 2018. The Company will continue applying the hedge accounting requirements of IAS 39 as permitted under IFRS 9.

The Company assessed its business model for managing the financial assets held by the Company and classified its financial assets into the appropriate IFRS 9 categories. The impact of the reclassification was as follows:

	Measurement category		Carrying amount		Difference
Financial asset	IAS 39	IFRS 9	IAS 39 £m	IFRS 9 £m	£m
AFS debt securities	AFS	Fair value through other comprehensive income	5.1	5.1	–
Loan to subsidiary undertakings	Amortised cost	Amortised cost	531.8	531.8	–
Derivative financial instruments	Fair value through profit or loss	Fair value through profit or loss	1.4	1.4	–
Cash and cash equivalents	Amortised cost	Amortised cost	236.1	236.1	–

UK sovereign debt securities were reclassified from AFS to fair value through other comprehensive income as the AFS category has been removed under IFRS 9. This is appropriate as the Company's business model is achieved by collecting contractual cash flows and selling these investments, and contractual cash flows are solely payments of principal and interest. The treatment of changes in fair value remain consistent and as a result there is no impact on equity. There is no difference in the carrying amount of any financial assets under IAS 39 and IFRS 9. IFRS 9 accounting policies adopted in the period are presented in note 1.5.

1.3 Investment in subsidiaries

Investment in subsidiaries is stated at cost less any impairment.

1.4 Dividend income

Dividend income from investment in subsidiaries is recognised when the right to receive payment is established.

1.5 Financial assets

Financial assets are classified at initial recognition and subsequently measured at amortised cost or fair value through other comprehensive income. The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and the Company's business model for managing them. The Company initially measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs.

Amortised cost
Assets which are held to collect contractual cash flows, and with contractual terms which give rise to cash flows which are solely payments of principal and interest on the principal amount outstanding, are subsequently measured at amortised cost, unless designated as fair value through profit or loss. Financial assets at amortised cost are subsequently measured using the effective interest method and are subject to impairment. Gains and losses are recognised in the income statement when the asset is derecognised, modified or impaired.

Fair value through other comprehensive income
Assets which are held both to collect contractual cash flows and to sell the financial asset, where the contractual terms of the asset give rise to cash flows which are solely payments of principal and interest on the principal amount outstanding, are measured at fair value through other comprehensive income, unless designated as fair value through profit or loss. Movements in the carrying amount are taken through other comprehensive income, except for gains or losses recognised in the income statement when the asset is derecognised, modified or impaired.

Impairment
On recognition of a financial asset measured at amortised cost or fair value through other comprehensive income, an expected credit loss allowance is recognised by multiplying the financial asset's gross carrying amount by the probability of default multiplied by the loss given default.

At each balance sheet date, the Company assesses on a forward-looking basis, whether there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as held at amortised cost or fair value through other comprehensive income, is expected. This assessment depends on whether there has been a deterioration in the instrument's credit quality since initial recognition. The Company measures the expected loss as the difference between the carrying amount of the asset or group of assets including the allowance for expected losses, and the present value of estimated future cash flows from the asset or group of assets, discounted at the effective interest rate of the instrument. The expected loss allowance is based on assumptions about risk of default and expected loss rates. The Company uses judgement in making these assumptions and selecting the inputs to the impairment calculation based on the credit quality and history of the financial asset or group of financial assets, as well as existing market conditions and forward-looking expectations.

Impairment losses, including the expected credit allowance, are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses. If in a subsequent period the amount of the expected impairment allowance reduces, and this can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. A financial asset is written off when there is no reasonable expectation of recovery.

Hedge accounting
The Company has utilised the transition for hedge accounting option in IFRS 9 to continue applying the hedge accounting requirements of IAS 39.

2. Investment in subsidiary undertakings

	2018 £m	2017 £m
At 1 January	3,099.1	3,084.3
Additional investment in subsidiary undertakings	20.9	14.8
Impairment of investment in subsidiary undertakings	(1.0)	–
At 31 December	3,119.0	3,099.1

The subsidiary undertakings of the Company are set out on page 186. Their capital consists of Ordinary Shares which are unlisted. In all cases, the Company owns 100% of the Ordinary Shares, either directly or through its ownership of other subsidiaries, and exercises full control over their decision making.

2. Investment in subsidiary undertakings continued

Name of subsidiary	Place of incorporation and operation	Principal activity
Directly held by the Company:		
Direct Line Group Limited[1]	United Kingdom	Intermediate holding company
DL Insurance Services Limited[1]	United Kingdom	Management services
Finsure Premium Finance Limited[1]	United Kingdom	Non-trading company
Inter Group Insurance Services Limited[1]	United Kingdom	Non-trading company
UK Assistance Accident Repair Centres Limited[1]	United Kingdom	Motor vehicle repair services
UK Assistance Limited[1]	United Kingdom	Dormant[7]
U K Insurance Business Solutions Limited[1]	United Kingdom	Insurance intermediary services
U K Insurance Limited[2,3]	United Kingdom	General insurance
Indirectly held by the Company:		
10-15 Livery Street, Birmingham UK Limited[4]	Jersey	Dormant[7]
Churchill Insurance Company Limited[1]	United Kingdom	General insurance
Direct Line Insurance Limited[1]	United Kingdom	Dormant[7]
DL Support Services India Private Limited[5]	India	Support and operational services
DLG Legal Services Limited[6]	United Kingdom	Legal services
DLG Pension Trustee Limited[1]	United Kingdom	Dormant[7]
Farmweb Limited[1]	United Kingdom	Non-trading company
Green Flag Group Limited[2]	United Kingdom	Intermediate holding company
Green Flag Holdings Limited[1]	United Kingdom	Intermediate holding company
Green Flag Limited[2]	United Kingdom	Breakdown recovery services
Intergroup Assistance Services Limited[1]	United Kingdom	Non-trading company
National Breakdown Recovery Club Limited[1]	United Kingdom	Dormant[7]
Nationwide Breakdown Recovery Services Limited[1]	United Kingdom	Dormant[7]
The National Insurance and Guarantee Corporation Limited[1]	United Kingdom	Dormant[7]
UKI Life Assurance Services Limited[1]	United Kingdom	Dormant[7]

Notes:
1. Registered office at: Churchill Court, Westmoreland Road, Bromley, BR1 1DP.
2. Registered office at: The Wharf, Neville Street, Leeds, LS1 4AZ.
3. U K Insurance Limited has a branch in the Republic of South Africa.
4. Registered office at: 22 Grenville Street, St Helier, JE4 8PX, Jersey.
5. Registered office at: 4 Aradhana Enclave, Sector 13, Rama Krishna Puram, New Delhi, South West Delhi, Delhi, 110066, India.
6. Registered office at: 42 The Headrow, Leeds, LS1 8HZ.
7. In accordance with the requirements under sections 394A and 448A of the Companies Act 2006, there is no requirement to audit a dormant company.

3. Other receivables

	2018 £m	2017 £m
Loans to subsidiary undertakings[1]	531.9	612.2
Trade receivables due from subsidiary undertakings	15.1	–
Other debtors	1.3	1.3
Total	548.3	613.5
Current	48.3	113.5
Non-current	500.0	500.0
Total	548.3	613.5

Note:
1. Included in loans to subsidiary undertakings is a £500 million unsecured subordinated loan to U K Insurance Limited. The loan was advanced on 27 April 2012 at a fixed rate of 9.5% with a repayment date of 27 April 2042. There is an option to repay the loan on specific dates from 27 April 2022. If the loan is not repaid on 27 April 2022, the rate of interest will be reset at 6-month LIBOR plus 8.16%. All loans are neither past due nor impaired.

4. Current and deferred tax

	2018 £m	2017 £m
Per balance sheet:		
Current tax assets	–	16.1
Current tax liabilities	(0.2)	–
Deferred tax liabilities	(0.6)	(0.6)

The table below analyses the major deferred tax liabilities recognised by the Company and movements thereon.

	Provisions and other temporary differences £m	Fair value through other comprehensive income revaluation reserve £m	Total £m
At 1 January 2017	(0.3)	(0.1)	(0.4)
Credit to the income statement	0.4	–	0.4
Credit to other comprehensive income	–	0.1	0.1
Other movements	(0.7)	–	(0.7)
At 31 December 2017 and 2018	**(0.6)**	**–**	**(0.6)**

5. Derivative financial instruments

	Notional amount 2018 £m	Fair value 2018 £m	Notional amount 2017 £m	Fair value 2017 £m
Derivative assets				
Designated as hedging instruments:				
Foreign exchange contracts[2]	18.5	1.4	17.3	1.0
Total	18.5	1.4	17.3	1.0
Derivative liabilities				
Designated as hedging instruments:				
Foreign exchange contracts[2]	18.5	1.4	17.3	1.0
Total	18.5	1.4	17.3	1.0

Notes:

1. The derivative assets and liabilities are both classified as level 2 within the Group's fair value hierarchy set out in note 40 of the consolidated financial statements.
2. The foreign exchange cash flow hedges have been entered into on behalf of the Group's subsidiary companies.

6. Financial investments

	2018 £m	2017 £m
Fair value through other comprehensive income debt securities[1]	5.1	5.2

Note:

1. The fair value through other comprehensive income debt securities are fixed interest UK sovereign debt classified as level 1 within the Group's fair value hierarchy which is set out in note 40 of the consolidated financial statements.

7. Cash and cash equivalents

	2018 £m	2017 £m
Cash at bank and in hand	0.1	3.8
Short-term deposits with credit institutions[1]	236.0	205.5
Total	236.1	209.3

Note:

1. This represents money market funds with no notice period for withdrawal.

8. Share capital and capital reserves

Full details of the share capital and capital reserves of the Company are set out in notes 29 and 30 to the consolidated financial statements.

9. Tier 1 notes

Full details of the Tier 1 notes of the Company are set out in note 31 to the consolidated financial statements.

10. Subordinated liabilities

	2018 £m	2017 £m
Subordinated guaranteed dated notes	253.0	252.7

The subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 at a fixed rate of 9.25% and have a redemption date of 27 April 2042. The Company has the option to repay the notes on specific dates from 27 April 2022. If the notes are not repaid on 27 April 2022, the rate of interest will be reset at a rate of 6-month LIBOR plus 7.91%.

On 8 December 2017, the Company repurchased £250 million nominal value of subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million.

The Company has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The notes are unsecured, subordinated obligations of the Company, and rank pari passu without any preference among themselves. In the event of a winding up or insolvency, they are to be repaid only after the claims of all other senior creditors have been met.

The notes are guaranteed by U K Insurance Limited, a principal subsidiary of the Company.

The aggregate fair value of subordinated guaranteed dated notes at 31 December 2018 was £297.8 million (2017: £328.7 million).

11. Borrowings

	2018 £m	2017 £m
Loans from fellow subsidiaries within the Group[1]	100.7	84.5

Note:

1. Included in the above is a loan of £73.0 million (2017: £61.5 million) from UK Assistance Accident Repair Centres Limited. Other loans of £23.7 million from fellow Group subsidiaries are repayable on demand and are subject to interest on outstanding balances based on the average 3-month LIBOR rate.

12. Trade and other payables

	2018 £m	2017 £m
Payables to subsidiary undertakings	–	0.1
Payables to third parties	1.7	1.3
Total	1.7	1.4

13. Dividends

Full details of the dividends paid and proposed by the Company are set out in note 14 to the consolidated financial statements.

14. Share-based payments

Full details of share-based compensation plans are provided in note 35 to the consolidated financial statements.

15. Risk management

The risks faced by the Company, arising from its investment in subsidiaries, are considered to be the same as those in the operations of the Group. Details of the key risks and the steps taken to manage them are disclosed in note 3 to the consolidated financial statements. The Company also holds, on behalf of its subsidiaries, designated hedging instruments which relate to foreign currency supplier payments.

16. Directors and key management remuneration

The Directors and key management of the Group and the Company are the same. The aggregate emoluments of the Directors are set out in note 10 to the consolidated financial statements, the compensation for key management is set out in note 41 to the consolidated financial statements and the remuneration and pension benefits payable in respect of the highest paid Director are included in the Directors' remuneration report in the Governance section of the Annual Report & Accounts.

17. Post balance sheet event

On 28 February 2019, the Board of U K Insurance Limited, a subsidiary undertaking of the Company, agreed to repay £250 million of its £500 million subordinated loan to the Company. This transaction is expected to occur in March 2019.

Corporate website

The Group's corporate website is www.directlinegroup.co.uk. It contains useful information for the Company's investors and shareholders. For example, it includes press releases, details of forthcoming events, essential shareholder information, a dividend history, a financial calendar, and details of the Company's AGM. You can also subscribe to email news alerts.

Market

The Company has a premium listing on the UK Listing Authority's Official List. The Company's Ordinary Shares (EPIC: DLG) are admitted to trading on the London Stock Exchange.

Share ownership

Share capital

You can find details of the Company's share capital in note 29 to the consolidated financial statements.

Dividends

The Company pays its dividends in sterling to shareholders registered on its register of members at the relevant record date.

Shareholders can arrange to receive their cash dividend payments in a bank or building society account by completing a dividend mandate form. This is available from the Company's registrar, Computershare Investor Services Plc ("**Registrar**"), in the UK. You can find the Registrar's contact details on page 196. Alternatively, shareholders can access their shareholdings online and download a dividend mandate form from the Investor Centre. You can find details of this below.

Dividend Reinvestment Plan

The Company offers a Dividend Reinvestment Plan. This enables shareholders to use their cash dividends to buy the Company's Ordinary Shares in the market. You can find more details on the Company's website.

Shareholder enquiries

Shareholders with queries about anything relating to their shares can contact our Registrar.

Shareholders should notify the Registrar of any change in shareholding details, such as their address, as soon as possible.

Shareholders can access their current shareholding details online at www.investorcentre.co.uk/directline. Investor Centre is a free-to-use, secure, self-service website that enables shareholders to manage their holdings online. The website allows shareholders to:

- check their holdings;
- update their records, including address and direct credit details;
- access all their securities in one portfolio by setting up a personal account;
- vote online; and
- register to receive electronic shareholder communications.

To access information, the website requires shareholders to quote their shareholder reference number. Shareholders can find this number on their share certificates.

Shareholder warning

Almost five thousand people contact the FCA about share fraud each year – and victims lose an average of £20,000.

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that prove to be worthless or non-existent. Or they can offer to buy shares at an inflated price in return for you paying upfront. They promise high profits. However, if you buy or sell shares in this way, you will probably lose your money.

How to avoid share fraud

- Remember that FCA-authorised firms are unlikely to contact you unexpectedly offering to buy or sell shares;
- Do not converse with them. Note the name of the person and firm contacting you, then end the call;
- To see if the person and firm contacting you are authorised by the FCA, check the Financial Services Register at www.fca.org.uk;
- Beware of fraudsters claiming to be from an authorised firm; copying its website; or giving you false contact details;
- If you want to phone the caller back, use the firm's contact details listed on the Financial Services Register at www.fca.org.uk;
- If the firm does not have contact details on the Register or they tell you the details are out of date, call the FCA on 0800 111 6768;
- Search the list of unauthorised firms to avoid at www.fca.org.uk/consumers/scams;
- Remember that if you buy or sell shares from an unauthorised firm, you cannot access the Financial Ombudsman Service or Financial Services Compensation Scheme;
- Get independent financial and professional advice before handing over any money, and
- If it sounds too good to be true, it probably is.

Report a scam

If fraudsters approach you, tell the FCA using the share fraud reporting form at www.fca.org.uk/consumers/scams. You can also find out more about investment scams on the same web page.

You can call the FCA Consumer Helpline on 0800 111 6768.

If you have already paid money to share fraudsters, call Action Fraud on 0300 123 2040.

Tips on protecting your shares

- Keep all your certificates in a safe place. Alternatively, consider holding your shares in the UK's electronic registration and settlement system for equity, called CREST, or via a nominee;
- Keep correspondence from the Registrar that shows your shareholder reference number in a safe place, and shred unwanted correspondence;
- Inform the Registrar as soon as you change your address;
- If you receive a letter from the Registrar regarding a change of address and you have not recently moved, contact them immediately;
- Find out when your dividends are paid and contact the Registrar if you do not receive them;
- Consider having your dividends paid direct into your bank account. You will need to complete a dividend mandate form and send it to the Registrar. This reduces the risk of cheques being stolen or lost in the post;
- If you change your bank account, inform the Registrar of your new account details immediately;
- If you are buying or selling shares, only deal with brokers registered in the UK or in your country of residence; and
- Be aware that the Company will never call you concerning investments. If you receive such a call from a person saying they represent the Group, please contact the Company Secretary immediately, by calling +44 (0)1132 920 667.

Electronic communications and voting

The Group produces various communications. Shareholders can view these online, download them, or receive paper copies by contacting the Registrar.

Shareholders, who register their email address with our Registrar, or at the Investor Centre, can receive emails with news on events, such as the AGM. They can also receive shareholder communications electronically, like the Annual Report & Accounts and Notice of Meeting.

Dealing facilities

Shareholders who wish to buy, sell or transfer their shares may do so through a stockbroker or a high street bank; or through the Registrar's share-dealing facility.

You can call or email the Registrar regarding its share-dealing facility using this contact information:

- For telephone sales, call +44 (0)370 703 0084 between 8.00 am and 4.30 pm, Monday to Friday, excluding public holidays, and
- For internet sales, go to www.investorcentre.co.uk/directline. You will need your shareholder reference number, as shown on your share certificate, or your welcome letter from the Chairman.

Dividend tax allowance

From April 2018, the dividend tax-free allowance was reduced from £5,000 to £2,000 across an individual's entire share portfolio. Above this amount, individuals will pay tax on their dividend income. The rate of this tax depends on their income tax bracket and personal circumstances. The Company will continue providing registered shareholders with a confirmation of the dividends paid. Shareholders should include this with any other dividend income they receive when calculating and reporting total dividend income received to HMRC. The shareholder is responsible for including all dividend income when calculating tax requirements. If you have any tax queries, please contact your financial adviser.

Financial calendar

2019

Date	Event
05 March	Preliminary Results 2018 announcement
04 April	"Ex-dividend" date for 2018 final dividend and special interim dividend
05 April	Record date for 2018 final dividend and special interim dividend
24 April	Final date for election under the Dividend Reinvestment Plan
08 May[1]	Trading update for the first quarter of 2019
09 May	Annual General Meeting
16 May	Payment date for 2018 final dividend and special interim dividend
31 July[1]	Half Year Report 2019
08 August[1]	'Ex-dividend' date for 2019 interim dividend
09 August[1]	Record date for 2019 interim dividend
15 August[1]	Final date for election under the Dividend Reinvestment plan
06 September[1]	Payment date for 2019 interim dividend
05 November[1]	Trading update for the third quarter of 2019

Annual General Meeting

The 2019 AGM will be held on 9 May 2019 at the offices of Deloitte LLP, 2 New Street Square, London EC4A 3BZ, starting at 11.00 am. All shareholders will receive a separate notice convening the AGM. This will explain the resolutions to be put to the meeting.

Note:
1. These dates are subject to change.

Term	Definition and explanation
Actuarial best estimate ("ABE")	The probability-weighted average of all future claims and cost scenarios. It is calculated using historical data, actuarial methods and judgement. A best estimate of reserves will therefore normally include no margin for optimism or, conversely, caution.
Annual Incentive Plan ("AIP")	This incentivises the performance of Executive Directors and employees over a one-year operating cycle. It focuses on the short to medium-term elements of the Group's strategic aims.
Available-for-sale ("AFS") investment	Financial assets that are classified as available-for-sale. Please refer to the accounting policy note 1.12 on page 139.
Average written premium	Average written premium is the total written premium at inception divided by the number of policies.
Bootstrapping	A statistical sampling technique used to estimate reserve variability around the Actuarial Best Estimate ("**ABE**"). Results produced from bootstrapping historical data are used to set and inform the level of margin incorporated in the management best estimate ("**MBE**").
Buy-As-You-Earn Plan	The HM Revenue & Customs approved Buy-As-You-Earn Share Incentive Plan gives all employees the opportunity to become shareholders in the Company.
Capital	The funds invested in the Group, including funds invested by shareholders and retained profits.
Claims frequency	The number of claims divided by the number of policies per year.
Claims handling provision (provision for losses and loss-adjustment expense)	Funds the Group sets aside to meet the estimated cost of settling claims and related expenses that the Group considers it will ultimately need to pay.
Clawback	The ability of the Company to claim repayment of paid amounts for equity-settled share-based payments.
Combined operating ratio ("COR")	The sum of the loss, commission and expense ratios. The ratio measures the amount of claims costs, commission and operating expenses, compared to net earned premium generated. A ratio of less than 100% indicates profitable underwriting. Normalised combined operating ratio adjusts loss and commission ratios for a normal level of expected major weather events in the period.
Commission expenses	Payments to brokers, partners and price comparison websites for generating business.
Commission ratio	The ratio of commission expense divided by net earned premium.
Company	Direct Line Insurance Group plc (the "**Company**").
Current-year attritional loss ratio	The loss ratio for the current accident year, excluding the movement of claims reserves relating to previous accident years, and claims relating to major weather events.
Deferred Annual Incentive Plan ("DAIP")	For Executive Directors and certain members of senior management, at least 40% of the AIP award is deferred into shares typically vesting three years after grant. The remainder of the award is paid in cash following year-end.
Direct own brands	Direct own brands include Home and Motor under the Direct Line, Churchill and Privilege brands, Rescue under the Green Flag brand and Commercial under the Direct Line for Business brand.
Earnings per share	The amount of the Group's profit after deduction of the Tier 1 coupon payments allocated to each Ordinary Share of the Company.
Employee Representative Body	A forum that represents all employees, including when there is a legal requirement to consult employees.
Expense ratio	The ratio of operating expenses divided by net earned premium.
Finance costs	The cost of servicing the Group's external borrowings.
Financial Conduct Authority ("FCA")	The independent body that regulates firms and financial advisers.
Financial Reporting Council	The UK's independent regulator responsible for promoting high-quality corporate governance and reporting to foster investment.
Gross written premium	The total premiums from contracts that began during the period.
Group	Direct Line Insurance Group plc and its subsidiaries ("**Direct Line Group**" or the "**Group**").
Incurred but not reported ("IBNR")	Funds set aside to meet the cost of claims for accidents that have occurred but have not yet been reported to the Group. This includes an element of uplift on the value of claims reported.
In-force policies	The number of policies on a given date that are active and against which the Group will pay, following a valid insurance claim.
Insurance liabilities	This comprises insurance claims reserves and claims handling provision, which the Group maintains to meet current and future claims.
International Accounting Standards Board ("IASB")	A not-for-profit public interest organisation that is overseen by a monitoring board of public authorities. It develops IFRS standards that aim to make worldwide markets transparent, accountable and efficient.
Investment income yield	The income earned from the investment portfolio, recognised through the income statement during the period divided by the average assets under management ("**AUM**"). This excludes unrealised and realised gains and losses, impairments, and fair value adjustments. The average AUM derives from the period's opening and closing balances for the total Group. (See Appendix A – APM from page 194).

Term	Definition and explanation
Investment return	The investment return earned from the investment portfolio, including unrealised and realised gains and losses, impairments, and fair value adjustments.
Investment return yield	Investment return divided by the average AUM. The average AUM derives from the period's opening and closing balances. (See Appendix A – APM from page 194).
Leverage	Tier 1 notes and financial debt (subordinated guaranteed dated notes) as a percentage of total capital employed.
Long-Term Incentive Plan ("LTIP")	Awards made as nil-cost options or conditional share awards, which vest to the extent that performance conditions are satisfied after a period of at least three years.
Loss ratio	Net insurance claims divided by net earned premium.
Malus	An arrangement that permits unvested remuneration awards to be forfeited, when the Company considers it appropriate.
Management's best estimate ("MBE")	These reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal ABE.
Net asset value	The net asset value of the Group is calculated by subtracting total liabilities (including Tier 1 notes) from total assets.
Net claims	The cost of claims incurred in the period less any claims costs recovered under reinsurance contracts. It includes claims payments and movements in claims reserves.
Net earned premium	The element of gross earned premium less reinsurance premium ceded for the period where insurance cover has already been provided.
Net investment income yield	The net investment income yield is calculated in the same way as investment income yield but includes the cost of hedging. (See Appendix A - APM from page 194).
Ogden discount rate	The discount rate set by the Lord Chancellor and used by courts to calculate lump sum awards in bodily injury cases.
Operating profit	The pre-tax profit that the Group's activities generate, including insurance and investment activity, but excluding finance costs.
Own Risk and Solvency Assessment ("ORSA")	A forward-looking assessment of the Group's risks and associated capital requirements, over the business planning period.
Periodic payment order ("PPO")	These are claims payments as awarded under the Courts Act 2003. PPOs are used to settle some large personal injury claims. They generally provide a lump-sum award plus inflation-linked annual payments to claimants who require long-term care.
Prudential Regulation Authority ("PRA")	The PRA is a part of the Bank of England. It is responsible for regulating and supervising insurers and financial institutions in the UK.
Reinsurance	Contractual arrangements where the Group transfers part or all of the accepted insurance risk to another insurer.
Reserves	Funds that have been set aside to meet outstanding insurance claims and IBNR.
Restructuring costs	Restructuring costs are costs incurred in respect of the business activities where the Group has a constructive obligation to restructure its activities.
Return on equity	Return on equity is calculated by dividing the profit attributable to the owners of the Company after deduction of the Tier 1 coupon payments by average shareholders' equity for the period.
Return on tangible equity ("RoTE")	Return on tangible equity is adjusted profit after tax divided by the Group's average shareholders' equity, less goodwill and other intangible assets. For 2018 profit after tax is adjusted to include the Tier 1 coupon payments dividend and for 2017 profit after tax is adjusted to exclude one-off costs in relation to the buy-back of subordinated liabilities. It is stated after charging tax using the UK standard tax rate of 19% (2017: 19.25%). The profit after tax for comparative periods prior to 2017 is adjusted to exclude operating profit from the Run-off segment and restructuring and other one-off costs. (See Appendix A – APM from page 194).
Run-off	Refers to the lines of business no longer underwritten by the Group including Tesco Motor and Personal Lines Broker.
Solvency II	The capital adequacy regime for the European insurance industry, which became effective on 1 January 2016. It establishes revised capital requirements and risk management standards. It comprises three pillars: Pillar I, which sets out capital requirements for an insurer; Pillar II, which focuses on systems of governance; and Pillar III, which deals with disclosure requirements.
Solvency capital ratio	The ratio of solvency II own funds to the solvency capital requirement.
Total Shareholder Return ("TSR")	Compares share price movement with reinvested dividends as a percentage of the share price at the beginning of the period.
Underwriting result profit / (loss)	The profit or loss from operational activities, excluding investment return and other operating income. It is calculated as net earned premium less net insurance claims and total expenses.

Appendix A – Alternative performance measures

The Group has identified alternative performance measures ("**APMs**") in accordance with the European Securities and Markets Authority's published Guidelines. The Group uses APMs to improve comparability of information between reporting periods and reporting segments, by adjusting for either uncontrollable or one-off costs which impact on IFRS measures, to aid the user of the Annual Report in understanding the activity taking place across the Group. These APMs are contained within the main narrative sections of this document, outside of the financial statements and notes, and may not necessarily have standardised meanings for ease of comparability across peer organisations.

Further information is presented below, defined in the glossary on pages 191 to 192 and reconciled to the most directly reconcilable line items in the financial statements and notes. Note 4 on page 158 of the consolidated financial statements presents a reconciliation of the Group's business activities on a segmental basis to the consolidated income statement. All note references in the table below are to the notes to the consolidated financial statements on pages 136 to 181.

In 2018, the Group ceased presenting APMs for the following measures:

– adjusted diluted earnings per share;

– operating profit from Ongoing operations; and

– adjusted profit before tax and after tax from Ongoing operations.

These APMs no longer provide relevant information, as 2018 results are based on total Group operations including the Run-off segment and restructuring costs which are included in the Motor segment.

Group APM	Closest equivalent IFRS measure	Definition and/or reconciliation	Rationale for APM
Current-year attritional loss ratio	Net insurance claims	Current-year attritional loss ratio is defined in the glossary on page 191 and is reconciled to loss ratio (discussed below) on page 158.	Expresses claims performance in the current accident year in relation to net earned premium.
Combined operating ratio	Operating profit	Combined operating ratio is defined in the glossary on page 191.	This is a measure of underwriting profitability whereby a ratio of less than 100% represents an underwriting profit and a ratio of more than 100% represents an underwriting loss and excludes non-insurance income.
Investment income yield	Investment income	Investment income yield is defined in the glossary on page 191 and is reconciled on page 194.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Investment return yield	Investment return	Investment return yield is defined in the glossary on page 192 and is reconciled on page 194.	Expresses a relationship between the investment return and the associated opening and closing assets net of any associated liabilities.
Loss ratio	Net insurance claims	Loss ratio is defined in the glossary on page 192 and is reconciled in note 4.	Expresses claims performance in relation to net earned premium.
Net investment income yield	Investment income	Net investment income yield is defined in the glossary on page 192 and is reconciled on page 194.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Return on tangible equity	Return on Equity	Return on tangible equity is defined in the glossary on page 192 and is reconciled on page194.	This shows performance against a measure of equity that is more easily comparable to that of other companies.
Tangible equity	Equity	Tangible equity is defined as equity (excluding Tier 1 notes) less intangible assets within the balance sheet and is reconciled on page 165.	This shows the equity excluding Tier 1 notes and intangible assets for comparability with companies who have not acquired businesses or capitalised intangible assets.
Tangible net assets per share	Net assets per share	Tangible net assets per share is defined as tangible equity (as above) expressed as a value per share and is reconciled in note 16 on page 165.	This shows the equity excluding Tier 1 notes and intangible assets per share for comparability with companies who have not acquired businesses or capitalised intangible assets.

Appendix A – Alternative performance measures continued

Additionally, the current-year attritional loss ratio within the analysis by division section has also been identified as an alternative performance measure, similarly reconciled to the financial statements and notes on page 29 and defined in the glossary on page 191.

Return on tangible equity[1]

	2018[2] £m	2017[2] £m
Operating profit	601.7	642.8
Finance costs	(19.1)	(103.8)
Profit before tax	582.6	539.0
Finance costs adjustment for one-off subordinated debt buy back	–	66.1
Coupon payments in respect of Tier 1 notes	(16.6)	–
Adjusted profit before tax	566.0	605.1
Tax charge	(108.9)	–
Tax charge (using the 2017 UK standard tax rate of 19.25%)	–	(116.5)
Adjusted profit after tax	457.1	488.6
Opening shareholders' equity	2,715.1	2,521.5
Opening goodwill and other intangible assets	(471.1)	(508.9)
Opening shareholders' tangible equity	2,244.0	2,012.6
Closing shareholders' equity	2,573.1	2,715.1
Closing goodwill and other intangible assets	(566.8)	(471.1)
Closing shareholders' tangible equity	2,006.3	2,244.0
Average shareholders' tangible equity[3]	2,125.2	2,128.3
Return on tangible equity	21.5%	23.0%

Investment income and return yields[1]

	Notes[4]	2018 £m	2017 £m
Investment income	6	159.2	167.1
Hedging to a sterling floating rate basis[5]	6	(30.8)	(27.0)
Net investment income		128.4	140.1
Net realised and unrealised gains excluding hedging	6	26.2	35.3
Investment return		154.6	175.4
Opening investment property		309.3	329.0
Opening financial investments		5,040.4	5,147.0
Opening cash and cash equivalents		1,358.6	1,166.1
Opening borrowings		(54.1)	(55.3)
Opening derivatives asset / (liability)[6]		55.1	(5.8)
Opening investment holdings		6,709.3	6,581.0
Closing investment property	19	322.1	309.3
Closing financial investments	26	4,737.8	5,040.4
Closing cash and cash equivalents	27	1,154.4	1,358.6
Closing borrowings	27	(62.0)	(54.1)
Closing derivatives asset[6]		11.8	55.1
Closing investment holdings		6,164.1	6,709.3
Average investment holdings		6,436.7	6,645.2
Investment income yield		2.5%	2.5%
Net investment income yield		2.0%	2.1%
Investment return yield		2.4%	2.6%

Notes:

1. See glossary on pages 191 and 192 for definitions.
2. Results for year ended 31 December 2018 are based on total Group operations including the restructuring costs and Run-off segment. Comparative data has been re-presented accordingly to include the restructuring costs and Run-off profits in the 2017 operating profit. The adjusted profit after tax reported in 2017 was £462.9 million and the return on tangible equity was 21.7%.
3. Mean average of opening and closing balances.
4. See notes to the consolidated financial statements.
5. Includes net realised and unrealised gains / (losses) of derivatives in relation to AUM.
6. See note 1 on page 36.

This Annual Report & Accounts has been prepared for, and only for, the members of the Company as a body, and no other persons. The Company, its Directors, employees, agents or advisers do not accept responsibility to any other person to whom this document is shown, or into whose hands it may come, and any such responsibility or liability is expressly disclaimed.

Certain information contained in this document, including any information as to the Group's strategy, plans or future financial or operating performance, constitutes "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "ambition", "anticipates", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "mission", "outlook", "over the medium term", "plans", "predicts", "projects", "propositions", "seeks", "should", "strategy", "targets" or "will" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this document and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, among other things: the Group's results of operations, financial condition, prospects, growth, strategies and the industry in which the Group operates. Examples of forward-looking statements include financial targets and guidance which are contained in this document specifically with respect to the return on tangible equity, solvency capital ratio, the Group's combined operating ratio, prior-year reserve releases, cost reduction, reductions in expense and commission ratios, investment income yield, net realised and unrealised gains and risk appetite range. By their nature, all forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future or are beyond the Group's control.

Forward-looking statements are not guarantees of future performance. The Group's actual results of operations, financial condition and the development of the business sector in which the Group operates may differ materially from those suggested by the forward-looking statements contained in this document, for example directly or indirectly as a result of, but not limited to, United Kingdom ("**UK**") domestic and global economic business conditions, the outcome of discussions within the UK parliament and discussions between the UK and the European Union ("**EU**") regarding the manner and terms on which, if any, the UK leaves the EU (usually called "**Brexit**") and the terms in due course of any future trading relationship between the UK and the EU, market-related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities (including changes related to capital and solvency requirements or the Ogden discount rate), the impact of competition, currency changes, inflation and deflation, the timing impact and other uncertainties of future acquisitions, disposals, joint ventures or combinations within relevant industries, as well as the impact of tax and other legislation and other regulation in the jurisdictions in which the Group and its affiliates operate. In addition, even if the Group's actual results of operations, financial condition and the development of the business sector in which the Group operates are consistent with the forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods.

The forward-looking statements contained in this document reflect knowledge and information available as of the date of preparation of this document. The Group and the Directors expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable law or regulation. Nothing in this document should be construed as a profit forecast

Neither the content of Direct Line Group's website nor the content of any other website accessible from hyperlinks on the Group's website is incorporated into, or forms part of, this document.

Registered office

Direct Line Insurance Group plc
Churchill Court
Westmoreland Road
Bromley
BR1 1DP

Registered in England and Wales No. 02280426
Company Secretary: Roger C Clifton

Telephone: +44 (0)1132 920 667
Website: www.directlinegroup.co.uk

Registrars

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol
BS99 6ZZ

Shareholder helpline: +44 (0)370 873 5880
Shareholder fax: +44 (0)370 703 6101
Telephone number for the hard of hearing:
+44 (0)370 702 0005
Website: www.computershare.com

Investor Centre
To find out more about Investor Centre, go to
www.investorcentre.co.uk/directline

Auditors

Deloitte LLP
Hill House
1 Little New Street
London
EC4A 3TR

Telephone: +44 (0)20 7936 3000
Website: www.deloitte.com

Legal advisers

Allen & Overy LLP
One Bishops Square
London
E1 6AD

Telephone: +44 (0)20 3088 0000
Website: www.allenovery.com

Slaughter and May
One Bunhill Row
London
EC1Y 8YY

Telephone: +44 (0) 20 7600 1200
Website: www.slaughterandmay.com

Principal banker

The Royal Bank of Scotland Group plc
280 Bishopsgate
London
EC2M 4RB

Telephone: +44 (0)131 556 8555
Website: www.rbs.com

Corporate brokers

Goldman Sachs International
Peterborough Court
133 Fleet Street
London
EC4A 2BB

Telephone: +44 (0)20 7774 1000
Website: www.goldmansachs.com

Morgan Stanley & Co. International plc
25 Cabot Square
Canary Wharf
London
E14 4QA

Telephone: +44 (0)20 7425 8000
Website: www.morganstanley.com

RBC Europe Ltd (trading as 'RBC Capital Markets')
Riverbank House
2 Swan Lane
London
EC4R 3BF

Telephone: +44 (0)20 7489 1188
Website: www.rbccm.com

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